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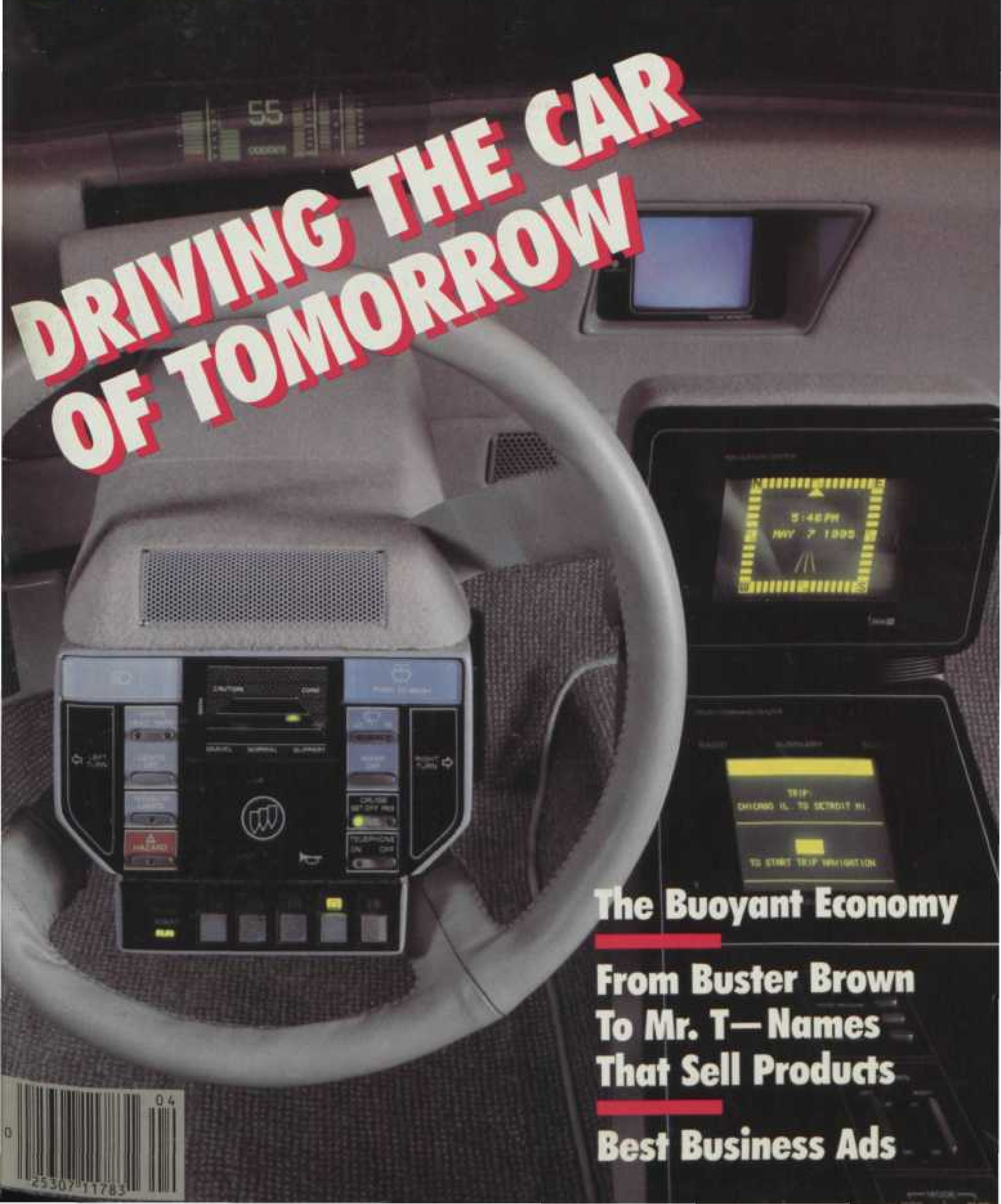

Driving the Car of Tomorrow

The Buoyant Economy

From Buster Brown To Mr. T—Names That Sell Products

Best Business Ads

Nation's Business®

PHOTO: DALE THOMPSON

Today the shows, tomorrow the streets: a look at future cars. 18

PHOTO: T. MICHAEL KEZA

Gloomy predictions about the economy dissipated in a healthy first quarter. 25

PHOTO: SUSAN GREENWOOD—LI

Labor leader Kirkland pinpoints unions' woes. 2

TECHNOLOGY

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Electronic dashboards, computerized guidance systems, radar and many more user-friendly devices are on Detroit's drawing boards as auto makers face the future determined not to get complacent again.

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Japanese and European auto makers are just as determined to keep abreast of new technology.

Technology at Work 69
It is now possible to tap into the information pool on what Uncle Sam is buying, and from whom. Also: graphics that go from PC to projector; recognizing innovators.

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A License To Sell 70
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Checking a pet's heart over the phone has led to a thriving veterinary supply service for two Brooklyn public health and computer experts.

The Kings of the Florida azalea business never intended to go it alone—but they're glad they did.

Karen S. Kennedy had a failure abroad before her marketing firm found success at home.

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PHOTO: STEVE SMITH

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PHOTO: RHODA BAER

Buster Brown and his dog Tige started licensing, and now the trickle has turned into a flood. 70

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COVER PHOTO: DASHBOARD OF BUICK QUESTOR © 1984 GREG SHARKO—POPULAR SCIENCE

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Closing the Laboratories

The powers delegated by the proposed Constitution to the Federal Government are few and defined. Those which are to remain in the State Governments are numerous and indefinite.

—*James Madison*, Federalist 45

What shall the States have to do? . . . This consolidated government will operate like an ambuscade. It will destroy the State governments, and swallow the liberties of the people.

—*Patrick Henry, 1788*

IT IS NOT OFTEN that our political debate follows the advice of George Mason, to "return to fundamentals." Usually we focus on issues of the day and time—funding the MX missile, or aiding the Contras in Nicaragua or deciding the fate of Amtrak. In recent weeks the level of discussion has shifted. For the first time in a long time, we are reexamining theories and myths and realities that go to the very heart of our system of government.

Is the whole theory of federalism to be discarded?

Several events in conjunction have compelled this re-examination. Last year, it will be recalled, the federal government served the states with a kind of ultimatum: Unless a sufficient number of states adopted mandatory seat belt laws, the government would impose an air bag requirement on everybody. Then came a similar threat from Congress: Unless the states raised their minimum drinking age to 21, they would lose a share of their federal aid for highways. In February the President sent his budget for 1985-86 to Capitol Hill; it came loaded with proposals for reducing the role of the national government in our lives. On February 19 the Supreme Court handed down an opinion that would vest sweeping powers in Congress to dominate state governments and effectively to destroy the last vestiges of state sovereignty.

Taken together, the several current events raise old questions. Was James Madison, the father of the Constitution, right or wrong? Are there *any* significant limits upon the power of the national government? Is the whole theory of federalism to be discarded? Almost 197 years have passed since Patrick Henry voiced his doleful prophecies in the Virginia ratification convention. If the High Court's opinion of February 19 should become settled law, Henry will have had the last word: For all practical purposes the states will have nothing to do, save to serve as impotent surrogates of federal power.

Consider that recent opinion. At issue was the power of the U.S. Labor Department over San Antonio's municipally owned bus system. Could the bus system be compelled to pay minimum wages and overtime just as if the system were privately owned? In 1968, when a similar question came before the High Court, the Court said yes, federal power is supreme. In 1976, when the identical question again came before the High Court, the Court said no, state power is supreme. In February, when the issue arose for the third time, the Court flip-flopped once more; by a vote of 5-4, federal power again was held supreme.

Does this tell us something about one of the most cherished myths of our society? This is the myth that "ours is a government not of men, but of laws." The notion is as hollow as a jug. In 1976 Justice Harry Blackmun felt one way; in 1985 he felt another way. Not one word of the Fair Labor Standards Act had been revised in the meantime; the commerce clause of the Constitution had not been amended. Nothing had changed but the mind of Harry Blackmun. It is precisely as Charles Evans Hughes said a long time ago: Ours is a government under the Constitution, "but the Constitution is what the judges say it is."

In the San Antonio case, Justice Blackmun gave such an expansive reading to the Commerce Clause that the 10th Amendment, as dissenting Justice Lewis Powell remarked, is effectively emasculated. The House, the Senate and the bureaucracy hereafter are to be "the sole judges of the limits of their own power."

If Powell is right, and if Patrick Henry's predictions have come true, the country will be poorly served. Granted, the nature of our society has changed prodigiously since Henry and Madison debated in 1788—but principles have not changed, and human nature has not changed, and man's lust for power remains unaltered. The original idea was for the states to serve as laboratories of political experiment. That idea is as wise and as valuable today as it was 200 years ago.

SUPPOSE the air bag idea is a bad idea: In that event, it may be imposed as a nationally bad idea. Suppose 21 is an unworkable, unfair or unenforceable minimum age for drinking: If the states are deprived of their opportunity to experiment, we shall have age 21 willy-nilly. In the great national concerns of war and peace, power must be national power; many other areas also demand national authority. But let us take care. To destroy federalism is to destroy one of the rocks on which our structure rests.

Colliding Head-On With the IRS

Thanks for providing the best analysis I have seen yet of the Internal Revenue Service's misguided new auto reporting rules ["Those IRS Vehicle Rules: They'll Drive You Mad," March]. You point out the inconsistencies that abound in this sweeping regulatory mandate.

If American businessmen and women are anything, they are the exceptions to the rule. These particular rules deny reality. We need more tax incentives to work productively, not more IRS regulations that produce paper work.

ROBERT W. KASTEN, JR.
U.S. Senate
Washington

You cannot have it both ways. You cannot expect the deficit to come down if taxes are not being collected.

I am president of my own company. I am on the road, and ever since I was audited 10 years ago, I have kept precisely the kind of log that is now required. My outside salesman and I can track every minute and everything we have done, over an entire year. The minimal amount of time required to get a handle on our activity has been repaid in much time and money gained. Keeping the log has allowed me to budget wisely my scarcest resource: time.

The IRS must collect the money that the government needs to operate, and there can be no doubt that there are many more opportunities for fraud without these logs than with them.

JOSEPH T. DRUECKER
President
Indiana Products Company
South Bend, Ind.

A nation apart

Re: "Casting the First Stone" [James J. Kilpatrick, February].

At last, a voice of reason in the wilderness of self-serving indignation at South Africa's policy of apartheid. As unattractive as apartheid may be to many Americans, little if anything is accomplished by threats of economic sanctions and the pointing of fingers by self-appointed saviors from the liberal contingent in Congress.

While the good senators and representatives rant and rave about the injustice of it all, the government of South Africa is slowly making progress toward an eventual equality of all South African residents.

STEVE R. SMIRNOFF
Anchorage, Alaska

Kilpatrick says that economic sanctions don't work, and that applying them to South Africa would be folly. Why won't they work? Is it because the United States has too many vested interests there?

Closing U.S.-owned factories would

Next Month in Nation's Business

New Breed of Bosses

Changes in the workplace are giving birth to new styles of management. What effects are automation or the need to spur innovation having? How are subordinates motivated to get superior quality into products? What about the doctrine of "tough love"?

Farming: The Real Story

The sky is *not* falling on American agriculture—despite the claims of a minority of farmers whose fate is tied more to federal programs than the marketplace. Experts say proper congressional action can make the food and fiber chain strong again.

Treatment for Health Costs

Rising costs of employe health care have given rise to an industry specializing in controlling those costs. A variety of firms have a variety of methods of saving business a bundle. What they do ranges from preventive medicine to auditing hospital bills.

Outsiders and the Small Firm

A small company's board of directors commonly is an all-in-the-family affair or limited to the firm's top executives. But some small enterprises are finding that bringing in outsiders can have a big effect on a business' growth.

be a devastating blow to black workers? I think it would do more harm to the Pretoria regime than to the workers.

WINSTON HOYTE
Brooklyn

I am not sure that the South African policy is morally indefensible, given the fact that two cultures are in conflict in that unhappy land.

I believe a good argument could be generated to support the notion that African people fare better in direct proportion to their exposure to Western European culture. If this is a valid position, the policies of South Africa are justified. For a people to adopt a new culture, time is the necessary element—lots of time.

The African majority is slowly adopting the culture of the white minority, and South Africa is well on the way to developing a modern society for all of its people.

JOHN R. CONOVER
Manager, Technical Services
Bel-Ray Company
Farmingdale, N.J.

The barter boomers

Re: "Barter Boom" [March].

Reaction to the article among members of our industry has been enthusiastic. The story was accurate, fair and objective. It underscores the phenomenon of barter that is taking place in the national economy.

We have been receiving inquiries, as a result of the article, from those who want to learn more about bartering. Anyone interested in more information can write to me at the address below.

JOSEPH WEISS
Deputy Director
International Reciprocal Trade Association
4012 Moss Place
Alexandria, Va. 22304

What Quimby Smith did

In your article on Roger Smith, the chairman of General Motors Corporation, [Lessons of Leadership, February], you have perpetuated an inaccuracy about Roger's father.

When Quimby Smith left Ohio, he came to Detroit (not northern Michigan) and was employed by Bundy Tubing Company, which had been founded by Harry Bundy in 1923. Quimby Smith became the financial officer of Bundy Tubing by the end of the 1930s, and Roger Smith's first job was indeed as a mail boy in our main plant.

However, Quimby Smith was not responsible for founding Bundy Corporation. Our chairman, W.W. Anderson, Jr., is the son of W.W. Anderson, an investment banker who bought Bundy Tubing from Harry Bundy in the 1920s and was the individual truly responsible for the company's growth and development.

RAYMOND H. STEBEN, JR.
Vice President-Finance
Bundy Corporation
Warren, Mich.

Shooting down registration

I feel that registration of handguns [Where I Stand, February] would not benefit the small businessman. If we have universal registration of hand-

LETTERS

guns, we will have universal nonregistration by criminals.

But I am in favor of stiffer penalties for crimes involving guns, including mandatory capital punishment for criminals who use a gun in a crime where a death results.

WALTER CADY
Gordon, Nebr.

Benefits and bucks

I wonder if there wasn't an error in James R. Morris' article "Benefit Growth: Back to the Days of Yore," [February]. The percentage increase for the total of all annual benefit increases is given as 1,077 percent. I believe that figure should be 1,177 percent ($7,582 divided by 644). If a weighted average increase is used (individual 1983 increase divided by total increase multiplied by percentage increase 1951-1983 for individual items), it would be 1,180 percent—a good agreement.

The columns for 1951 and 1983 add up to to the totals given, so somewhere about a 100 percent increase has been lost in the total percentage increase.

CHARLES F. GORDON
Cheltenham, Pa.

Editor's note: *Morris notes that he was giving a percentage for the increase in employe benefits between 1951 and 1983, and not a percentage showing how much greater the 1983 figure is than the 1951 figure. So he subtracted $644 (the 1951 figure) from $7,582 (the 1983 figure), yielding $6,938. And $6,938 divided by $644 yields 1,077 percent.*

Re: "Passing the Buck on Benefits" [February].

I own a company that employs more than 300 people. For some years I have been most concerned about the rapid increases in medical care costs. I have concluded that the fact that employers have been permitted to offer medical insurance tax-free has been the single biggest reason for the increases.

Business, and the community at large, would be better served if these benefits were taxable.

DONALD G. DUNN
Chairman
Plaskolite, Inc.
Columbus, Ohio

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WASHINGTON LETTER

▶ REAGAN ADMINISTRATION STRATEGY calls for pushing tax reform simultaneously with deficit-reduction efforts. President wants tax simplification debate conducted on his terms and will submit his proposals around May 1. Max Friedersdorf, new head of Reagan's congressional liaison team, tells business audience at U.S. Chamber of Commerce that idea is to head off situation in which Congress gives up on deficit reduction via spending cuts, instead uses its own version of tax reform as guise for raising taxes.

▶ WHITE HOUSE CONCERN that congressional appetite for budget cuts is lagging has been fueled by lawmakers' willingness to vote sharply increased funds for farmers. Administration officials worry that various special interest groups will view the action as a signal that a determined lobby can override deficit-reduction sentiment.

▶ LATEST ADDITION TO FISCAL JARGON in Washington is "Promised Land" budget. So called because it would achieve goals of the most dedicated budget cutters, going beyond the $50 billion in fiscal 1986 cuts proposed by President Reagan. Promised Land budget would add one-year freeze on military spending, Social Security cost-of-living adjustments to President's plan, raise total cuts significantly. Chief support for Promised Land approach comes from Senate Budget Committee Chairman Pete Domenici (R-N.M.).

▶ DRIVE FOR REPEAL of complex recordkeeping law on use of property for both business and personal reasons is gathering momentum on Capitol Hill. Rules drafted by Internal Revenue Service to justify tax claim for business use produced storm of protest from business people over time and expense that would be involved in maintaining necessary records. Rules cover autos, trucks, computers, planes, other property. Heaviest criticism centers on IRS demand for trip-by-trip log to show how cars, trucks are employed. IRS modified original regulations, but action failed to stem protests against paper work burdens remaining. U.S. Chamber of Commerce spearheads business demands for outright repeal.

▶ WAY NOW CLEAR FOR DISTRIBUTION of $7 billion in highway funds that have been held up by dispute over projects added by House and Senate members. States and various business groups urging release of the money had argued that pork barrel proposals of influential members of Congress should not be allowed to interfere with highway construction funded by gasoline taxes and user fees.

▶ PREPARATIONS FOR 1990 CENSUS already under way. Census Bureau is testing feasibility of new procedures to make data available sooner. Tests being held in Jersey City and Tampa. One experiment involves two-stage system for collecting data. Basic information would be obtained in first phase, more detailed data in second. Also being tested are improved automation procedures under which data would be converted at local level to computer-readable form. Tests will run through summer. Local meetings to obtain views of business people, other users of census data will be held in 36 cities this year. Similar sessions held in 29 communities last year.

▶ PRIVATE SECTOR ANALYSIS gives high marks to new Job Training Partnership Act. Placement of trainees in jobs exceeded goals during first nine months of new program. It replaced the Comprehensive Education and Training Act, widely criticized for spending vast sums on filling dead-end public works-type jobs that failed to prepare recipients for real-world job markets. Part-

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nership Act, which provides for extensive private sector participation, is placing 70 percent of its adult trainees in jobs. It also is placing 64 percent of youth trainees and 53 percent of trainees who are welfare recipients. Placement levels are higher, and costs per placement lower, than under CETA. Analysis also shows average wage of trainees placed is $4.61 per hour, compared with goal of $4.90, and participation rate of school dropouts is lower than anticipated.

▶ TRADE ADJUSTMENT ASSISTANCE PROGRAM should be allowed to expire as scheduled this year, opponents tell Congress. Program was established to provide special assistance to workers who lose jobs because of imports. Cash benefits, retraining are among provisions of law. Critics say it duplicates phases of Job Training Partnership Act and regular unemployment insurance programs.

▶ ANOTHER LAW THAT SHOULD BE ABOLISHED is Service Contract Act, says Rep. Arlan Stangeland (R-Minn.), sponsor of repeal bill. Act requires contractors who provide services to federal government to pay employes "prevailing wage." It's counterpart of Davis-Bacon Act on construction projects involving federal funds. Advocates for repeal of services act say savings could exceed $7 billion.

▶ U.S. AIRCRAFT INDUSTRY LOSING OUT in sales of smaller passenger planes to fast-growing regional airlines, National Academy of Engineering reports. Vigorous--and subsidized--competition from Europe, Japan, Indonesia and Brazil is cutting into U.S. industry's role in market. Academy recommends closer monitoring by Commerce Department of trade practices of foreign competitors, Export-Import Bank loans to foreign buyers of American planes, new strategies for domestic industry.

▶ UTILITY INDUSTRY IS DEFENDING "CWIP" policy from new attacks. Under CWIP (Construction Work In Progress) utilities can include in rate base cost of interest on construction loans. Federal Energy Regulatory Commission rule allowing that policy is under attack by some members of Congress. They argue consumers should not have to pay construction costs until they are actually receiving power from projects. Electric utilities say rule minimizes eventual rate shock and permits more efficient planning.

▶ JOB GROWTH will be strongest in western and southern parts of United States for rest of century, National Planning Association reports. Half of all new jobs will be in 30 metropolitan areas. Of the 30, seven are in California and five in Florida.

▶ MILITARY PENSIONS UNDER NEW ATTACK after heated controversy triggered by Budget Director David Stockman's assertion that Pentagon brass is more concerned about preserving generous pensions than in national security. Now Center for Budget and Policy Priorities, a nonprofit group, says military retirement system works against defense readiness by encouraging skilled personnel to leave at relatively young age.

▶ SWEEPING REFORMS ARE NEEDED in way Pentagon administers its construction projects, says Rep. Mickey Edwards of Oklahoma, senior Republican on military construction subcommittee of House Appropriations Committee. He wants defense planners to assign priorities to building projects that include military bases, missile sites, housing for personnel and "remodeling of bathrooms for historic preservation purposes." He also proposes that Pentagon be required to obtain new congressional approval for projects expected to incur cost overruns of 5 percent.

Kudos From Congress

Congress obviously recognizes the importance of small business to the nation's economy. Approximately 80 percent of the 83 veteran members of Congress responding to a recent survey rate small business as "critically important," noting that it is the major source of new "net" employment. The survey was released by Touche Ross & Company, an international accounting and consulting firm.

Respondents, who represent a geographic cross section of the country, say that small business benefits considerably from current economic gains. Changes in the business and individual tax structure would, they say, do the most to further spur the economy. Easing regulation and reporting requirements would also have major positive impact, according to many of the legislators.

Asked what areas of legislation have most hindered small business, legislators name taxation by 2 to 1 over the next most detrimental—import-export legislation.

Approximately 62 percent concede that recently passed tax laws have been far more beneficial to big business. Although there is no consensus as to how best to correct this imbalance, 38 percent of the respondents say they would favor a graduated tax rate until earnings exceed $50,000, 37 percent would support tax credits for hiring additional personnel, and 18 percent would back no tax for new businesses for the first three years if earnings are less than $100,000 annually.

Most respondents expect a decrease in the number of small business failures this year.

In keeping with this view, 83 percent say they do not support a bailout fund for small firms. On the other hand, 62 percent favor protectionist measures for some industries—namely, manufacturers of clothing and automotive products—from certain forms of foreign competition. In the nonservice category, the industry that needs the least protection, say most respondents, is high technology.

The Small Business Administration is the one government body—not excluding Congress itself—that has helped small business the most, the respondents say. The agency could, in their view, further enhance its effectiveness by concentrating on lending and procurement.

American jeans manufacturers suffer from a recent flood of denim product imports.

Listed as least helpful are the Internal Revenue Service and the Securities and Exchange Commission.

Help on Research Grants

If science- and technology-based firms with fewer than 500 employes want to take advantage of the Small Business Innovation Research grants but are unsure how to go about it, they need wonder no longer.

Peat, Marwick, Mitchell & Company, an accounting firm, has just published a 60-page guidebook, "Small Business Innovation Research Grants: How To Obtain Them To Finance Your Ideas."

Congress created the SBIR grant program—up to $550,000 is allocated per project—in 1982.

"Start-up financing, true 'seed' capital, has always been extremely difficult for small companies to obtain," says Peat Marwick executive S. Thomas Moser. "The magnitude of this funding presents a tremendous opportunity for entrepreneurship and technological innovation." All told, $1.5 billion has been set aside for the program through 1987—$250 million of it this year.

Companies that obtain SBIR funds to finance their research and product development are well positioned to obtain follow-up capital and federal procurement contracts for further business development, according to Peat Marwick.

The guidebook costs $5 and can be ordered from any Peat Marwick U.S. office or by writing to: S. Thomas Moser, National Director, High Technology Practice, Peat Marwick, Box 560-20, 345 Park Avenue, New York, N.Y. 10154.

Worth Noting

• The Senate Small Business Committee is holding field hearings in Tennessee, South Dakota, Illinois and possibly Montana and Arkansas to get small business reaction to the administration's tax simplification proposals.

Small business input is necessary, says committee Chairman Lowell Weicker (R-Conn.) because restructuring the nation's tax system could "significantly alter the financial course of the small business sector." Tax measures that provide "effective economic incentives" should not be sacrificed "at the altar of simplicity," he says.

The committee is specifically interested in provisions that would repeal the investment tax credit; replace the accelerated cost recovery system with a slower depreciation formula; provide direct expensing of all or a portion of equipment costs; and eliminate the current capital gains exclusion while indexing the basis of capital property.

• An entrepreneur's Starter Kit, initially offered gratis by the accounting firm of Coopers & Lybrand, as reported here in February, is now available only in return for a $5 fee. Write to Howard Bailen at the firm, 1251 Sixth Avenue, New York, N.Y. 10020.

• The International Foundation of Employee Benefit Plans will sponsor its Employee Benefits Institute for Small Businesses May 6-8 in Palm Springs, Calif. Alternatives in meeting the benefits needs of employes while complying with changing legislation and regulatory requirements, will be explored, along with the impact of current federal tax proposals. Contact IFEBP at P.O. Box 69, Brookfield, Wis. 53005; phone: (414) 786-6700.

• The Small Business Administration has designated May 5-11 as National Small Business Week in Washington. Honored at that time will be entrepreneurs from each of the 50 states, the District of Columbia and Puerto Rico.

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New Quarterly Payments Rules

By Gerald W. Padwe, C.P.A.

PHOTO: WIDE WORLD PHOTOS

Caught up in the need to get income tax returns filed by the middle of April, taxpayers may forget another important deadline.

With April 15 approaching rapidly, most of us are all too aware of the need to get those Form 1040s in the mail. For many taxpayers, though, that is also the date for filing another form, with a check attached—the first estimated tax payment for 1985.

Individuals are required to make such quarterly payments if their federal income tax liability for the year is expected to exceed what they pay through withholding by more than $500 (up from $400 for 1984). There are penalties for failing to pay the required quarterly installments. The 1984 tax act made significant changes in the rules governing payment of estimated taxes.

Under prior law the Internal Revenue Service was not permitted to waive altogether the penalty for underpayment, regardless of what caused it. Now, however, the IRS can waive the penalty if underpayment has been caused by a disaster or some other unusual circumstance, such as the death or serious illness of the taxpayer.

Early this year, the IRS announced that it would waive any such penalties for 1984 for Social Security recipients who were unaware that the taxable portion of Social Security benefits had to be considered in making 1984 estimated tax payments. The IRS stressed, however, that the penalty would be waived only to the extent the underpayment was attributable to the tax on Social Security benefits.

The 1984 law has also limited the number of available routes to reducing or eliminating quarterly estimated tax payments. To avoid the penalty for underpayment, taxpayers must now have paid, in quarterly installments, the smaller of 80 percent of this year's tax or 100 percent of the tax shown on last year's return. The estimated tax must cover the regular income tax, self-employment tax and (new this year) any alternative minimum tax. The required payment may then be reduced by any allowable credits and also by any tax withheld.

The first installment of the estimated income tax for 1985 is due on April 15 even if the taxpayer is granted an extension of the deadline for filing the 1984 income tax return.

A taxpayer entitled to a refund on the 1984 income tax return may have that amount credited against the 1985 estimated income tax, even when the filing deadline for the 1984 return has been extended.

Home Office Deductions

Generally, you cannot deduct expenses related to an office in your home unless the home office (1) is used exclusively and regularly for business purposes and (2) is either your principal place of business or used as a place to meet with clients, patients or the like. Further, if you are an employe, the home office must be for the convenience of the employer.

These general rules, however, are subject to numerous interpretations, as seen by the proliferation of court cases in this area over the past several years. Two recent cases illustrate that, in certain situations, home office deductions may be available where not necessarily expected.

In the first case, a university professor was assigned a campus office that he shared with several colleagues. He also maintained a home office that he used exclusively for writing and research related to his university position. Both the IRS and Tax Court disallowed any deductions for the home office, on the grounds that the university supplied an office and that the home office was for his convenience, not his employer's.

But the U.S. Court of Appeals for the Second Circuit decided that the professor's research and writing activities at home consumed 80 percent of his work time and were the focus of his business activities.

The court also found that the university-provided office was not adequate, given that the professor was required to share it with other faculty members and that it was not a secure place to leave research materials and equipment. Therefore, the home office deduction was permitted.

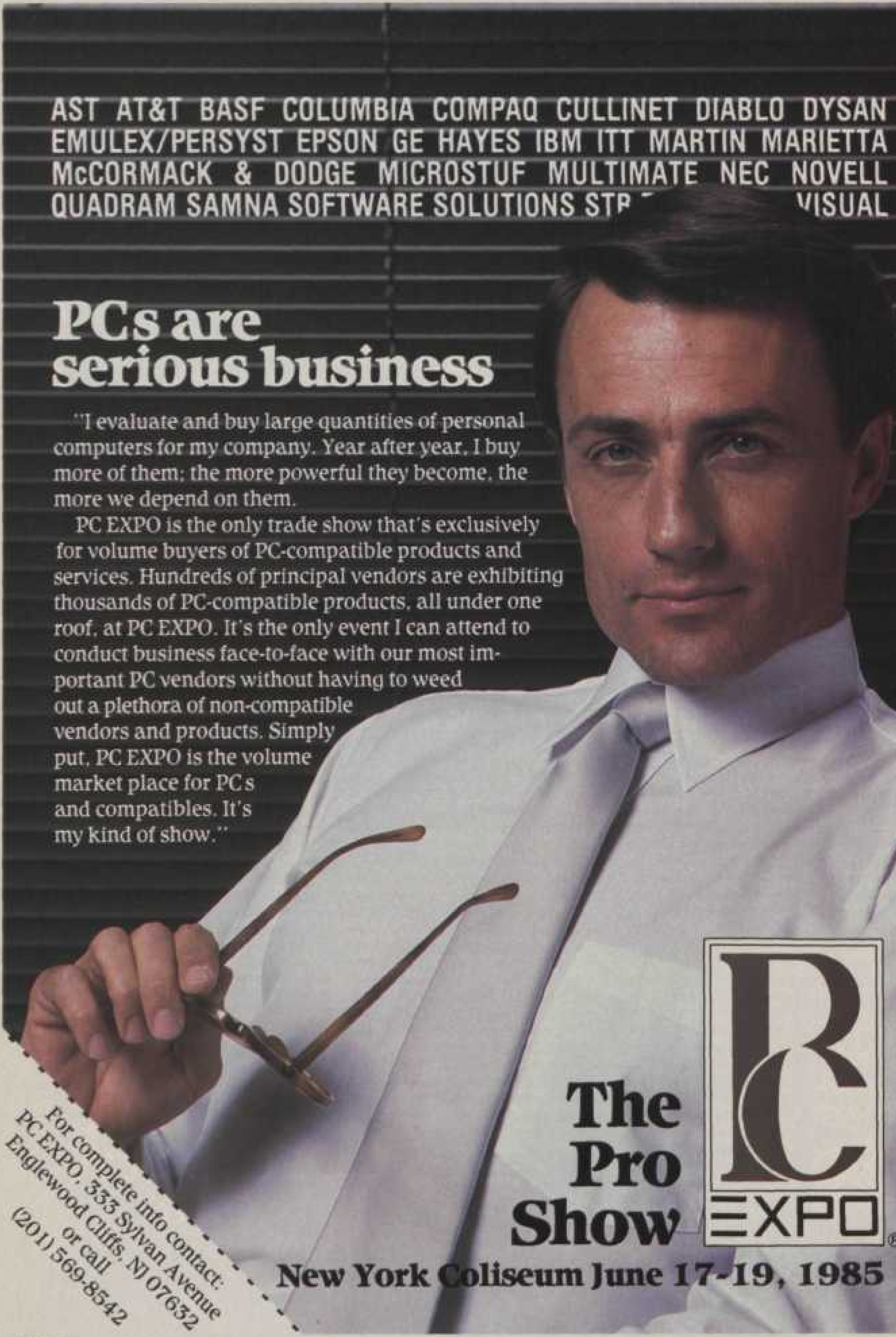
In the second case, an employe and shareholder of an accounting firm, with significant administrative responsibilities, was expected to do a substantial amount of work at home. He leased part of his home to the firm and was paid a monthly rental that he reported as income. In turn, he deducted a portion of the costs of his home (which turned out to be less than the rental received).

The Tax Court, agreeing with the IRS that the taxpayer had received a rental greater than fair value, adjusted the deductible amount to reflect actual rental value, since a taxpayer's deductible expenses cannot exceed the rental income where part of a residence is rented to others.

But the court approved the general principle that the taxpayer was entitled to deduct expenses up to the amount of fair rental income.

If a specific portion of your home is used exclusively for business purposes, some advance tax planning can greatly improve the odds that your home office expenses will be deductible. ▣

GERALD W. PADWE *is national director–tax practice for Touche Ross & Co.* For Your Tax File *is an information service for readers. See tax and legal advisers on specific cases.*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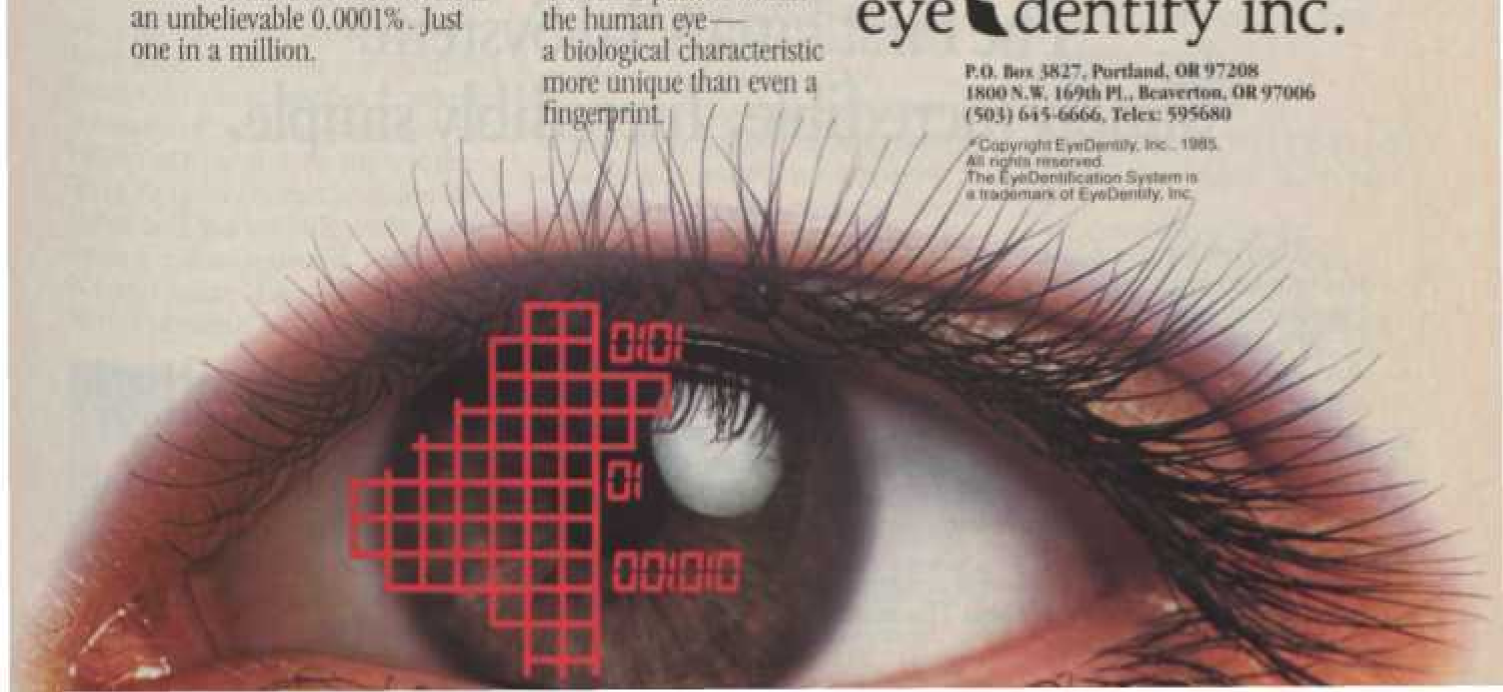

PHOTO: GREG SHARKO—POPULAR SCIENCE

Future cars, as exemplified by this Buick Questor prototype, will offer a variety of information on display screens.

PHOTOS: T. MICHAEL KEZA

GM engineer Ronald Dork is working on a navigation system using signals from satellites.

The User-Friendly Car of Tomorrow

Electronics are remaking the ways autos will be built and driven.

By Mike Lewis

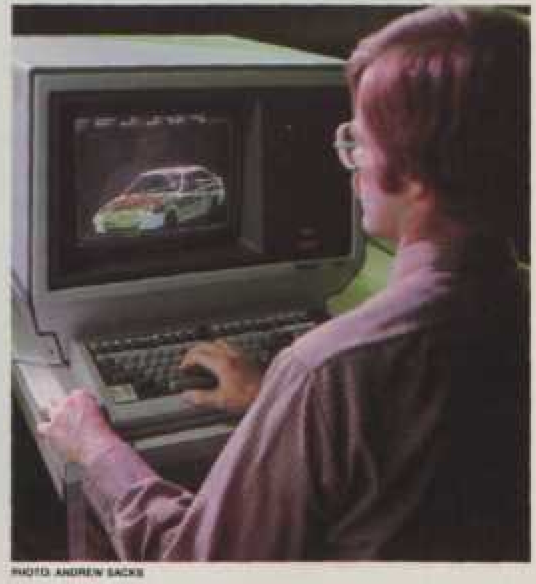

PHOTO: ANDREW SACKS

THE PILOT SITS DOWN in his cockpit and punches in the combination on a numerical keypad to start the engine. The seat belt automatically falls into place. The pilot feels for the control that starts his navigation system. His precise location is displayed on a screen at his fingertips.

He quickly plots a course on the color maps that pop up on the display screen, then switches the display from the navigation system to a monitor so he can check on various electronic functions. Seeing that all is well, he calls up detailed controls for the FM stereo radio, adjusts the bass setting and returns the display to the all-function monitor.

The pilot starts off, banking around a turn. Then the suspension system, alerted by its built-in radar, compensates for a pothole. (Yes, even the "pilots" who drive cars of the future will have to contend with potholes.)

Planners and designers for America's auto makers say all these features could be available on the typical car just five years from now.

U.S. auto manufacturers are independently pursuing a series of advances in technology that will virtually reinvent the car. Silicon Valley has come to Detroit. Talk of navigation systems linked electronically to satellites in space, and of seeing-eye supensions and engine compartments that will look more like the insides of computers than old-fashioned mechanical parts, has become commonplace among the engineers and designers now planning domestic cars of the early 1990s.

Behind all the new-age talk of microprocessors and aerodynamic bodies lies a very contemporary concern: How can Detroit iron, pulling expensive labor and old ways of doing things, zoom along with racy Japanese competitors?

A visitor to Detroit is struck by an atmosphere charged with conflicting emotions: An enthusiastic mood about the new cars and better ways to build them is mixed with worry about the fierce level of competition in what has become an international marketplace.

What will such sweeping change mean for the U.S. auto industry? "It's going to go upside down," predicts Kenneth S. Mack, who directs long-range product strategy for the Chrysler Corporation. In the reinvented car, Mack says, the driver will continue to sit behind the wheel, but what he sees before him will be designed for greater ease of use.

"Ergonomics, or the personal aspects of the car, will improve," Mack says, so that a driver can reach out and use controls in a natural way, seldom needing to shift his eyes from the road ahead. The relationship of the controls to the driver will be so important, he predicts, that the control pod will move along with the steering wheel if it is shifted to a different position. Tilt wheels are likely to be more common in the '90s.

PHOTOS: DALE THOMPSON

Chrysler displays one of its prototypes at the prestigious Chicago Auto Show.

A Chrysler engineer uses a computer in the design of components for a future car.

The information on a display screen can be switched at the touch of a finger to give varied information.

Ford's Urby concept car gives auto buyers an idea of what to expect for family transportation by the early 1990s.

Mack says the Chrysler staff feels the challenge of the future—a sense of challenge shared at Ford Motor Company and General Motors Corporation. "For the whole design staff it's the most exciting time I've ever known," says George Moon, a GM design executive who has three decades' experience on that staff.

David E. Rees, a top design executive at Ford, says his company is confident that its recent aero car designs presage what autos will look like over the next several years—"we're very pleased and very bullish on our new products."

"It's a different kind of era that we're entering now," says Richard A. Teague, who is a consultant at American Motors Corporation after retiring as vice president for automotive styling. Teague says the econobox—the small, boxy car—is dead and that prospective buyers will have a greater variety of choices—from two-seaters to vans—than in the past.

Some controls on future dashboards will not require the driver to move his hands from the steering wheel, says Harry Mathews, manager of the manufacturing automation and engineering unit at Arthur D. Little, Inc., a Cambridge, Mass., consulting firm. Voice synthesis and recognition have progressed so much that in the future a driver will be able to tell his car what to do through verbal commands such as, "Activate left directional signal."

At first, each car will probably recognize the voices of only one or two masters, but eventually cars should be able to obey the voice commands of any driver—a potential boon for car-rental companies. Commands will be begun with "car" or some similar code word to catch the electronic servant's attention, Mathews says. Otherwise, a driver casually mentioning to a passenger that "we ought to go see the leaves change in Vermont" might find his car instantly plotting a course.

FINDING DESIRED routes will be much easier, too. Mack envisions using cassettes furnished by an auto club or oil company that would display a map on the control screen, giving the kind of information that today's trip tickets from auto clubs give in printed form.

General Motors has been working for several years on an even more ambitious navigation system that would have a small computer in the car's trunk to receive information from a network of navigation satellites in space, says Ronald A. Dork, a GM engineer working on the project. The car's precise location could be plotted on a display-screen map, furnished by the same kind of cassette envisioned by Chrysler planners. The driver could then use a joystick to project his intended path and use his maps to plot his course.

Buick is among manufacturers that have cars to demonstrate electronic controls likely to be common by the early 1990s. The Buick prototype, the Questor, has several display screens as well as a computer printer.

Electronics in cars will quadruple in dollar value from now to 1990 despite the rapidly declining cost of microcircuitry, predicts Ralph Colello, manager of the automotive technology unit at Arthur D. Little. "The carburetor is dead," Colello proclaims, to be buried by electronic ignitions that need no distributor—all a part of manufacturers' determination to reduce maintenance.

Concern that electronics will defoliate the legions of "shade tree mechanics" is unfounded, Colello says, because "we're building a generation of people who will tinker with electronics" as earlier generations stroked engines.

"Downsizing" that has shrunk domestic cars since "fuel crisis" was added to the popular vocabulary appears to be at an end, says Moon of GM. "Cars aren't going to get bigger," says Chrysler's Mack, "but the configuration of the car will be better planned for space," so that passengers will have a greater sense of spaciousness. New manufacturing techniques are helping make this possible, says Ford's Rees.

Molding of materials can help reduce the depth of the car's skin that separates the exterior body from the interior. More sharply angled windshields, aimed at maintaining an aerodynamic wedge shape, will also provide more front seat room, Rees says.

The petroleum glut, by putting fear of shortages in the back seat, has led to an increased demand for larger cars

PHOTOS: T. MICHAEL KEZA

GM designer George Moon compares a sketch with a clay model in one of the studios looking toward the future.

Chrysler long-range product strategist Kenneth S. Mack thinks Detroit will "go upside down" to meet the challenge of imports.

that presents a problem for the domestic manufacturers. They like to sell high-profit large cars, but those cars lower the overall fuel economy of all the autos a company manufactures. As a result, Ford and GM have asked for a relaxation of federal fuel-economy requirements under which each U.S. company must reach a fleet average of 27.5 miles per gallon by the current model year. Without such a relaxation, the companies face stiff financial penalties. Chrysler, which has gone further in converting to smaller models, opposes such a move.

In contemporary models, maintenance has been a serious problem as greater reliance on advanced electronics has confounded mechanics who lack updated training. In a few years, engineers say, maintenance will be simplified because sophisticated electronic diagnostic systems will be included in all cars. It will become normal, they say, to have the control panel monitor the car's system and warn of problems in a much more detailed way than do the still-rudimentary devices in some cars today.

And, Mack says, mechanics in large garages like those in most dealerships will have electronic equipment they can plug into a faulty system to identify the offending circuit board or microchip, which can then be replaced. "You can almost record the birth-to-grave history of the car," says Arthur D. Little's Mathews.

IN THE ever-continuing fight against weight and expensive stamping of steel, economy-conscious auto makers will rely more on "plastics," by which they mean a wide variety of easily molded synthetic materials. Steel, though, will be in cars for a long time to come, predicts Mack, because it is able to withstand the 350 degrees to 375 degrees Fahrenheit of paint-curing ovens. Plastic bodies, like that of today's Pontiac Fiero, are expected to be reserved for low-volume models.

General Motors' creation of the Saturn Corporation as a new venture freed of past ways of doing things, in the hope of economically producing small cars in the United States, is one of the more dramatic recent Detroit developments. But the search for more efficient ways to make cars is universal.

In the past, Mack says, manufacturing processes were determined by what designers said cars would look like. Today, he says, manufacturing executives are included in initial planning so that production efficiencies are provided for in the basic design. He says the whole production cycle is being made more efficient in an effort to "put predictability into the process," from production considerations in the basic design to the search for a balance between high-volume production of basic cars and allowing customers some selection in what goes into the car. He predicts that domestic cars will follow the imports' example of selling cars well equipped, with only a few additional options.

The way cars are made will change, just as the way most mass-manufactured products are made will change. Most auto people say car design by computer is still in its infancy, but to develop what Mack calls a "central core of information," Chrysler has installed a computer system shared by the design and manufacturing staffs. "We're looking at paperless planning, vision robots and maintenance robots," Mack

A Cocoon of Safety

Increased emphasis on aerodynamics and electronics has not reduced manufacturers' efforts to produce safe cars.

The advances in engineering and design made possible by new, more powerful computers now allow engineers to calculate a car's crashworthiness before it is built. Prototype vehicles carrying lifesize dummies—equipped with sophisticated electronic sensors—are crashed into barriers to determine the nature and severity of possible injuries to humans at specific speeds.

Federal safety regulations require 35-mile-per-hour test crashes of all car models, with the results published annually.

The goal for all manufacturers is to design cars that are crushed at a controlled rate in a crash, so that only external areas of the cars, and not the passenger compartment, are affected.

Ford, for example, plans a "crush distance" of 26 inches to 30 inches, allowing that much space from the front bumper to the base of the windshield on the cars it designs so that much of the energy of a crash can be absorbed outside the passenger compartment.

Auto size—one of the factors affecting safety—appears to be declining in importance as the trend toward smaller vehicles ends. No one disputes the fact that smaller cars tend to offer less protection than larger cars in crashes.

On the other hand, the thinner doors planned for some future cars may well offer less protection because of their diminished mass, some engineers concede.

The greatest potential safety increase does not require engineering, says Christopher Kennedy, Chrysler Corporation's director of federal government affairs. "We are concentrating on increasing safety belt use," says Kennedy, a Chrysler engineer for 28 years. The federal government estimates that the number of traffic fatalities would be halved if everyone used seat belts.

Unless states accounting for two thirds of the national population require seat belt use, the federal government will require manufacturers to install restraints such as air bags or automatic safety belts. Without action by the states, the restraint systems will have to be installed on 10 percent of 1987 model year cars and 100 percent of 1990 cars.

says, envisioning the day when there will be fewer blue collars and more metal ones on the production floor.

All those robots will have a big impact on employment, the United Auto Workers union predicts. UAW researcher Peter Unterweger says the union has 630,000 members who work for auto manufacturers in the United States and Canada today (the UAW's Canadian branch plans to break away and form a separate union). "You could easily lose another 100,000 jobs by 1990"—a drop of nearly 16 percent in five years—Unterweger predicts.

The UAW has made job security a major priority, negotiating for retraining programs.

Auto manufacturers are also looking in other directions to cut production costs. "We're going to rely more on suppliers to do the engineering and testing," Mack says. U.S. companies are moving their stamping facilities into assembly plants to reduce costs and time as they try to take advantage of techniques for economical "just in time" delivery of supplies—techniques popularized by Japanese producers.

PHOTO: ANDREW SACKS

Ford designers Walter Gollwitzer (left) and Jim Bartle look over plans for the Barchetta, a two-seater designed by Ford's Ghia studio.

PHOTO: BURKE UZZLE—WOODFIN CAMP

Chrysler engineers look at a mockup of a minivan, a type of vehicle developed in this decade by Chrysler.

ONE OF THE manufacturers' goals, Mack says, continues to be producing cars that attract young people: "The key thing is to make the guy feel good about his first car." If he does, the reasoning goes, he will be reluctant to change brands.

In that buying decision, "the appearance is still going to be the key to the customer," says GM's Moon, who adds that "shape is the significant big thing" that will be changing as cars abandon boxiness for a rounder look. Moon acknowledges that Ford has been a pioneer in rounder designs, for example with its Thunderbird and Tempo. However, Moon says that "there are different ways of doing round; our cars are going to have a character that's totally GM." He adds, "I think the pressure for lowness is over."

Interiors, Moon says, will see an integration of elements as seats look more sculpted and doors flow into the dashboard. Because electronic components are constantly being made smaller, he says, controls will be closer to the driver's hand, allowing use of a touch screen, which may include a built-in cellular telephone—something GM planners think will be a great selling point for delivery people and emergency service technicians.

General Motors now offers 22 lines of models and plans to increase the differentiation in appearance between cars from the various divisions, Moon says, as a way of providing a distinct image for each division: "We're trying to be more market-driven, not facility-driven," he says. In the past, there has often been little real difference between the look of a Chevrolet and, for instance, the Pontiac version of the same model, made in the same facility.

Ford's Rees sounds like the designer he is when he says "our products are becoming more refined and better executed," but in the next breath he reflects the new Detroit reality when he adds that the cars' fit and finish is now of high quality.

Explaining Ford's idea of the future, Rees moves his arm through the air, shaping an imaginary object much like an airplane wing. He describes cars of the 1990s whose wedge shapes are built around short hoods that slope from a

PHOTO: ANDREW SACKS

Because aerodynamics is vital, new models pay visits to a wind tunnel to fine-tune their "slipperiness."

PHOTO: MGM

Ford's Probe IV concept car turned up in this scene from the futuristic MGM movie "2010," but it is already a bit old hat. Ford is planning a Probe V.

low front to cut wind resistance up to a windshield whose glass follows the same plane.

Inside the company's design studio, concepts have taken form: models, from some made of clay to drivable ones, fill the floor. They range from early possibilities for the Aerostar van that Ford is to introduce this June to sporty station wagons and the Barchetta two-seater sports convertible designed by the Ghia studio in Turin, Italy, which Ford owns and where Rees is a vice president.

Near models close enough to production—meaning later in this decade—that they are covered when a visitor enters is a wooden mockup of Probe V, successor to Ford's Probe IV, whose aerodynamic and electronic expression of the future has drawn much attention in auto shows.

Not all the models will lead to production cars, but they symbolize the U.S. auto industry's determination to capture the world's fancy—something that designers like Rees admit can go too far, intimidating consumers. "We have to be careful," he says, "that we don't get carried away with pure esthetics." After all, few auto shoppers are eager to sit down in a car and see what appears to be the cockpit of a 747. "We have to make sure that those electronics don't overwhelm the consumer," Rees says. Some European engineers deride some Japanese and U.S. concept cars' numerous color-display screens, calling them "Tokyo by night."

The effort to help the driver keep his eyes on the road could lead to projected control-panel information on the windshield or on a fixed plastic screen just below the windshield, Rees says. Maybe, he says with a gleam in his eye, information will be projected in holographic images—the kind that show up out of thin air—to tell the driver how fast he is going. "Perhaps the technology doesn't support the idea yet," Rees concedes.

What technology does support is a car for 1990 different from any version of the horseless carriage yet seen on American roads, as the domestic companies seek to develop crafts that will soar past the imports in the hearts of automobile "pilots" everywhere. NB

The Shape of Cars To Come

A visitor to the office complexes in suburban Detroit where plans for domestic cars are developed years before those cars roll into dealers' showrooms is struck by top automotive designers and engineers' obvious excitement—and by their reluctance to say or show anything that could be of help to competitors across town or across an ocean.

In General Motors' design building, for instance, each of the corporation's divisions has its own design studio—and designers and other planners are allowed access only to their own studios. Engineers working on innovations in the way cars work squirm uncomfortably when asked too-detailed questions about the wonders electronics will bring to cars.

An overview of the significant differences between today's cars and those of the 1990s, based on interviews with auto company executives and industry analysts, shows that:

- Electronic components such as electronic ignitions and diagnostic systems are going to become increasingly important. (For details, see main story.)
- Corrosion-resistant materials, including plastics and steel that is galvanized on both sides, will be in greater use. The drive to improve corrosion protection continues, as the manufacturers experiment with different treatments to protect metals from salt.
- Diesels will regain popularity because of their potential for higher fuel efficiency than gasoline engines. Use of direct-injection systems, now available for some truck diesels, will add to the advantage in efficiency. Other alternative fuels, such as coal-based methanol, are possibilities for the 1990s.
- Aerodynamic designs will become the rule, with the short hood area of wedge-shaped vehicles leading to shorter engines and different kinds of headlights. A car's wind resistance is measured by the "coefficient of drag." For every 10 percent drop in CD comes a 2 percent increase in fuel efficiency, experts say. Cars in the 1970s had a CD of about 0.5, and in the 1990s most will have a CD of 0.2 to 0.3.
- Continuously variable transmissions may replace today's three- or four-speed automatic transmissions.
- Antiskid braking, now available only for some expensive models, will become commonplace.
- Electric power steering will replace hydraulic power steering to allow for varying assistance according to the driving need. A car could retain road "feel" at highway driving speeds, for example, while offering a powerful assist in close-quarters maneuvering.
- Active suspension systems will transform cars' "ride." With the help of computers, cars may allow drivers to select a firm or soft ride and be able to bank gently around curves to keep the passenger compartment level. The autos of the 1990s may even be adjustable in height according to speed. When a car reaches about 45 miles an hour, it may be automatically lowered from 6 inches above the road to 2½ inches, to reduce wind drag.

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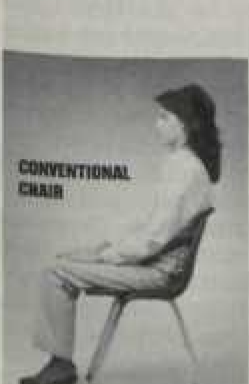

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A Star Wars Thrust From Abroad

By Paul Lienert

As U.S. AUTO MAKERS approach the cutting edge of computer technology, they are still taking cues from their counterparts in Europe and Japan.

Japanese manufacturers remain at the technological forefront in developing digital instrumentation and electronic sound systems. The European industry, meanwhile, has pioneered development of advanced, under-the-skin systems, including sophisticated engine and driveline controls and electronic antiskid brakes.

While many top imported sports and luxury models incorporate a number of computer-controlled devices and systems, the industry is still at least three years away from producing a totally automated vehicle.

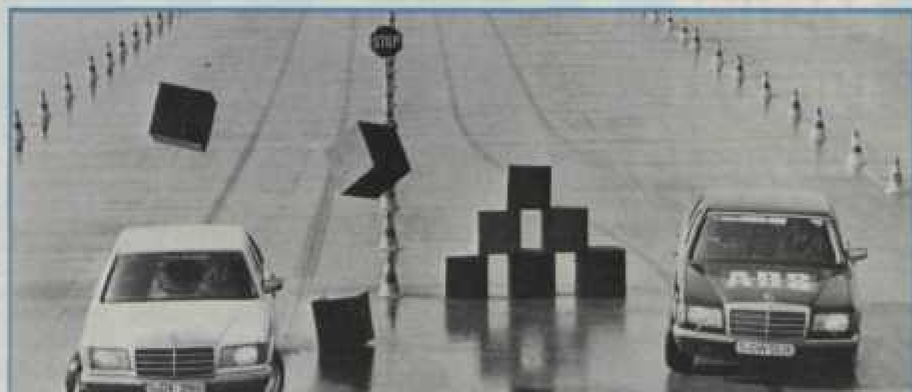

PHOTO: MERCEDES-BENZ

European auto makers have concentrated on advanced mechanical systems in their new models, such as antiskid brakes that keep the car on the right on the road.

Judging from developments in Europe and Japan, virtually all mechanical functions in the car of the future will be controlled by microprocessors.

Current Japanese technological trends can be spotted in the 1985 Toyota Cressida, whose features include systems likely to appear in other Japanese cars by the early 1990s.

Japanese engineers are developing engines that are computer-controlled, as well as electronically controlled four-speed automatic transmissions that allow drivers to select "power," "economy" or "normal" modes. The current Cressida's five-speed models have electronically adjustable shock absorbers for optimum ride and handling control. Inside, an optional digital instrument panel will feature trip computer, electronic climate control and an advanced AM-FM stereo cassette system with integral graphic equalizers.

Adjustable suspensions offered for several years on sporty models like the Nissan 300-ZX and Mazda 626 (and now standard on Subaru's top-of-the-line four-wheel-drive models) will become common. Other Japanese gizmos range from computer-controlled voice-warning systems to automatic leveling devices to minimize body roll and adjust weight distribution.

On nonproduction "show" cars, one of the unusual designs is Nissan's rain-activated wiper system: Electronic sensors in the windshield trigger the wipers at the first drops of rain.

A display car, the Pininfarina-designed Honda HP-X, incorporates electronic instruments, trip monitor, a computerized navigation system and a sonar device to aid parking.

On truly advanced mechanical systems, the Japanese tend to follow the lead of European innovators. Although such amenities as digital instruments, trip computers and electronic sound systems have been available for some years on Europe's leading luxury and sports models, most recent European development work has focused on the systems under the sheet metal.

ELECTRONIC antiskid brakes, for instance, were developed in Germany by major auto suppliers like Robert Bosch and Alfred Teves, in conjunction with engineers at BMW, Mercedes-Benz and Audi, among others. Standard for several years on many European cars, antiskid brakes are just now being offered in the United States.

Other companies, like Dutch supplier Van Doorne and France's Renault, have been developing computer-controlled transmissions, including the continuously variable automatic transmission that uses belts instead of gears to transmit engine power to the wheels.

One of Europe's newest technological showpieces is the 190-mile-per-hour Porsche 959, a turbocharged, four-wheel-drive throughbred developed for racing and, in limited numbers, for the street. The 959's computer controls most engine functions, as well as how much power is sent to each wheel on different road surfaces, for maximum traction and road-holding ability.

But Europe's first truly computer-integrated car may be the 1988 Lotus Etna, a sleek, wedge-shaped two-seater designed by Italy's Giugiaro.

This futuristic model will be powered by the British sports-car maker's new 4-liter V8 (computer-controlled, of course), coupled to a continuously variable automatic transmission and optional four-wheel drive, with electronic traction control, antiskid brakes and automatically adjustable hydraulic suspension. One computer will coordinate engine, transmission, driveline, brakes and suspension.

Although the instrument panel will feature conventional aircraft-type analog gauges, the entire cockpit will be microprocessor-controlled. Features will include electronic climate controls; satellite navigation and automatic warning system built into a state-of-the-art video display. The Etna will be breaking ground, especially with proximity radar and voice-activated wipers, windows and sound system, that will probably not be on other production cars until 1990.

Prospective customers will pay dearly for all this: Lotus expects the Etna, when it hits the streets in three years, to fetch around $150,000 a copy. NB

PAUL LIENERT *is automotive writer for the* Detroit Free Press.

A Spending Mood And A Buoyant Economy

By Peter A. Holmes

Shipments of lumber and other building materials are strong. Contractors see a busy year ahead, with mortgage money plentiful and interest rates down.

THE ECONOMY is back on track. Consumers are spending again. Retailers, wholesalers and manufacturers are cautiously restocking after an unexpected slowdown in last year's second half caused them to slash inventories.

"With the ducks we have lined up right now, we'll be going full tilt for the next six months," says J. Roger Glunt, president of Glunt Building Company, a western Pennsylvania contractor. "The weather is good, interest rates are down, and I'm optimistic."

His optimism seems contagious. Consumers will be in a spending mood at least through the end of 1985, says a University of Michigan survey of consumers' attitudes. But that does not mean shoppers will be going on a buying spree as they did last spring. Instead, shoppers will be bargain hunting, the survey says, because they believe that price inflation will be low as incomes increase only moderately.

The stock market rally has given a psychological boost to spending. On paper, individual investors' wealth has increased by up to $300 billion, says Kenneth T. Mayland, First Pennsylvania Bank's chief economist. This should boost purchases $15 billion to $18 billion, he says. Discretionary spending will also be spurred by lower energy prices.

The National Association of Home Builders says that contractors this year can be expected to put up 1.85 million units, 100,000 more than last year. One reason for this bullish forecast: Mortgage money is plentiful, and the price is right. In some regions 30-year conventional mortgages at less than 12 percent are available. Last summer comparable rates were above 15 percent.

Meanwhile, auto makers, the bellwether of manufacturing, are working overtime. Industry sources say that eight major auto makers with domestic assembly plants will be working "flat out" at least through the end of June. Record sales of cars and trucks are forecast.

For manufacturers of furniture, appliances and other long-lasting consumer durables, the outlook is good, too. The Michigan survey says that two of three families have favorable attitudes toward the purchase of "big ticket" items. The Whirlpool Corporation says that "major appliance industry sales will perform at a record high level in 1985."

Just three months ago, the talk on Wall Street was dominated by forecasts of a "growth recession." That pessimism has evaporated under consumers' ebullient mood. The consensus among forecasters is that the economy will grow between 3.5 and 4 percent this year. The midpoint of that range is the average for the third year of the past five expansions. A survey of National Association of Business Economists members shows they expect the economy to grow just 3.3 percent during the four quarters ending in December.

But some economic prognosticators are more bullish. Ronald D. Utt, U.S. Chamber of Commerce deputy chief economist, says the economy will grow "in excess of 5 percent" during 1985. The Chamber's recent track record in making such predictions has been much better than most. The NABE members, on the other hand, have consistently undershot.

SOME ECONOMISTS are downright bearish on the economy. Says S. Jay Levy, chief economist at Levy Economic Forecasts, of Chappaqua, N.Y.: "We expect a recession this year. We are hard-pressed to find a business that wants to increase inventories at the present time." The reason for this grim prediction? The poor showing of corporate profits. They were up just 2 percent in the fourth quarter of 1984. Levy says the growth rate of corporate profits will continue to fall from their peak, reached last spring, as inventories are reduced further. His advice to businesses: "Be cautious about advance ordering."

For the one third of the economy that is powered by business spending, the picture is brightening. Inventories are down after last year's correction, and order books should begin to fill up as manufacturers try to keep pace with demand, says Edward Guay, Cigna Corporation's chief economist. He sees the inventory-to-sales ratio peaking in the second half of the year, as it did last year.

Plunging interest rates—down four percentage points since last autumn—and the rally in equity prices "will carry capital spending sharply higher during the latter half of 1985," says Michael Evans, consulting economist to the American Production and Inventory Control Society. He says investment will rise at an 8 percent annual rate in the year's first half and 13 percent in the second half.

Some investors, however, say that spending and new ventures are being held up by uncertainty over government intentions to reform the tax laws.

"I'm amazed that the Treasury De-

Oppenheimer & Company's chief stock analyst, Francis Kelly, says Wall Street's bull market signals some investors' belief that a strong dollar has forced the Federal Reserve to ease up on its "scarce-dollar, heartland-be-damned policies."

partment should introduce a tax proposal which is so antigrowth, at a time when the President is relying on growth to reduce the federal deficit," says Christopher W. Brody, managing partner of the New York venture capital firm of Warburg Pincus and president-elect of the National Venture Capital Association.

He adds: "The Treasury tax proposal, if adopted, will have a very negative effect on capital formation." The proposal would give tax incentives to slow-growth companies when inflation is low, he says, and would discourage entrepreneurs from taking risks by taxing capital gains income at ordinary income rates.

Inflation is down, but not out. The broadest measure of inflation—the gross national product implicit price deflator—should continue to fall for the fourth straight year, says Edward Yardeni, Prudential-Bache Securities' research director. He says that measure of inflation will rise just 2.8 percent this year, after rising 3.7 percent in 1984, 3.8 percent in 1983 and 4.3 percent in 1982.

While inflation is falling, so is unemployment. Allen Sinai, Shearson/Lehman Brothers chief economist, sees the jobless rate falling to 6.7 percent by Christmas—a half percentage point below last Christmas. (The 3.5 percentage point drop between December, 1982, and December, 1984, was the largest 24-month drop on record.)

One key to understanding why the economy has come back so robustly is the change in the Federal Reserve Board's money policies. Bank reserves and cash in circulation rose $12.4 billion during the final two months of the year, according to the Federal Reserve Bank of St. Louis. That prompted checking and other transaction account balances in that period to rise at an annual rate twice as fast as the rate for the entire year. Prudential-Bache economist Deborah Johnson says that sparked the economic pickup and got consumer spending out of the doldrums.

WHAT IS AHEAD? Francis H.M. Kelly, research director at the New York investment firm of Oppenheimer & Company, says that a "crisis in heartland America" is forcing the Fed to rethink its monetary game plan. He says that distress in agriculture, mining and a broad cross section of manufacturing industries—caused by a greenback that has risen 50 percent in value against other currencies on a trade-weighted basis since 1980—is forcing the Fed to

A New Lease on Life for a

They called it D.O.A.—dead on arrival—before it got to Capitol Hill in February. Two months later, though, the administration's budget proposal is still kicking around. Why the new lease on life? Because enough congressmen seem to agree that the failure to control spending this year poses a colossal threat to the economy.

Despite four years of pulling back on the reins by the administration, spending is still galloping ahead: It is growing at twice last year's pace, three times the inflation rate and a third faster than the economy. If nothing is done, the government says, deficit spending next year could hit $232 billion, versus the $223 billion it foresees this year. Last year's $186 billion deficit pales by comparison.

Says Budget Director David A. Stockman: "The massive spending reductions required to restore fiscal balance require a fundamental reappraisal of the entire range of federal spending commitments."

The administration's proposals for selective program reforms, freezes, cuts, terminations and user fees that are expected to ax $51 billion from next year's budget (and $507 billion over five years) are now undergoing close scrutiny.

Some unexpected surprises have already surfaced. To meet the administration's goal of bringing next year's deficit down to 4 percent of the nation's output of goods and services, government auditors now say, $64 billion in spending cuts are needed.

"There will be disagreements about what we propose specifically for one program or another," Treasury Secretary James A. Baker III says of the ongoing negotiations with Congress. But, he says, "it makes sense" to freeze total program spending at last year's level—about $804 billion.

A growing number of influential groups agree. A high-powered coalition of seven business organizations, including the U.S. Chamber of Commerce, has told members of Congress that it supports a strategy of "spending restraint ... applied on an across-the-board basis with all programs and their recipients sharing equally the burden of reduced funding."

To back up those words, the Chamber's chairman, Van P. Smith, president of the Ontario Corporation, says he can accept spending cuts at the Small Business Administration and the Export-Import Bank, even though that would hurt programs that directly benefit business.

The National Governors' Association goes along with the freeze approach, too. Like the business organizations,

adopt a more accommodative money policy.

Kelly says that current disinflation policies are putting at risk all activities that face foreign competition—farming, machinery, textiles, oil, steel, extractive minerals, forest products, electronic components and capital goods, to name but a few.

"If the Fed responds to these conditions with a more flexible money policy," he says, "then we can muddle through without a recession." Otherwise, he says, "the U.S. must pawn off key possessions [wealth-producing assets] acquired over many decades of risk-taking, entrepreneurialism and capital investment."

THE RALLY in equities is a signal that the markets believe the Fed has changed course and abandoned what Kelly calls "the scarce-dollar, heartland-be-damned policies of the last five years." The markets, he says, now realize that faster money growth is pushing up the value of equities.

His stock market strategy? First, focus on companies that are not in competition with foreign firms. Once the dollar begins its descent, he says, Wall Street will favor those sectors that get more pricing flexibility and show improved foreign earnings, faster unit growth and widening profit margins.

Against the possibility that Kelly is right—that the Fed either has or might be pressured into throwing in the towel in the fight against inflation—members of a blue-ribbon panel of former economic policymakers calling themselves the Committee to Fight Inflation warn: "If the deficits are not quickly brought under control by budgetary measures, more stimulative monetary policies are likely to be pursued in the accurate belief that the real burden of the rapidly rising federal debt can be reduced by cheapening the dollars in which it is measured."

Says a committee spokesman, former Treasury Secretary Henry H. Fowler: "The strong dollar may create a false impression that inflation is under control and the Fed can therefore permit a more expansionary monetary policy."

Against the backdrop of an economic boom that is the envy of the world, the nation faces severe imbalances in the form of record budget and trade deficits. One cannot be cured without dealing with the other. Says chief trade negotiator William Brock: "The most important trade action that Congress can take this year is to reduce the federal deficit."


PHOTO: BRAD MARKEL

Reagan lieutenants told the Senate Appropriations Committee that budget deficits threaten the economy. From left: Budget Director David Stockman, Chairman Mark Hatfield, Treasury Secretary James Baker, Sens. Patrick Leahy, John Stennis.

"Dead on Arrival" Budget Proposal

though, it wants a freeze to encompass the more than half of the budget that goes to defense and Social Security. That would be accomplished by holding defense outlays to last year's level and suspending Social Security cost-of-living adjustments.

Nearly two thirds of those responding to a National Association of Business Economists poll favor a spending freeze, but less than half think Congress will go along.

Last November, voters turned down higher taxes as a solution to deficit spending. Many economists say that higher taxes could reduce economic growth and thus push the deficit higher.

There is a growing likelihood that two tax bills will emerge from Congress this year, though they may not raise much money.

"The possibility of a critical mass forming on the tax reform issue is growing," says Max Friedersdorf, newly appointed White House director of congressional liaison. He says a strategy in which the budget is dealt with before work on tax reform gets started "is a scenario for disaster." That approach would tempt Congress to raise taxes if spending cuts fall short, he says.

Friedersdorf, part of the team that helped engineer the President's legislative victories in 1981, says "there's no way [tax reform] will pass" without active business support. Treasury's Baker says the legislative strategy is still being worked out.

A second tax bill will be aimed at correcting numerous technical errors in last year's mammoth 1,500-page tax bill. It may also deal with sections of the tax code that are due to expire this year, such as the $5,000 credit for employer-paid educational assistance, the 25 percent credit for research and development costs, and allowances for solar energy and home conservation improvements.

Says one business lobbyist of the chances of all that happening this year: "Congress can't get away with doing nothing. If the President gives on defense and Social Security, the administration could get $35 billion to $40 billion in cuts this year. The consensus is there to do that much."

Finding a consensus is not always so difficult. Confronted by public complaints about new IRS recordkeeping chores, Congress shows signs of repealing offending legislation. So far, it seems that the public's outrage over huge budget deficits is either not strong enough or Congress is unmoved by the arguments favoring less spending.

—Peter A. Holmes

In Unions There Is Weakness

Organized labor's future is cloudy, with membership in a steep decline and leaders trying to woo back workers.

By Harry Bacas

AMERICA'S LABOR UNIONS have fallen so out of step with economic and social change that "within a generation they will have lost most of their influence in the national workplace."

That prediction is by Richard Lyles, a San Diego-based management consultant and author. But the premise on which it is based is widely shared.

"Not long into the next century," Lyles says, "the term 'bargaining unit' will be a forgotten concept. Those unions that do manage to survive will exist to serve social and fraternal needs."

And a recent AFL-CIO internal report admits: "Despite their accomplishments, unions find themselves behind the pace of change." The report adds that "unions must come to grips with the current and changed realities workers face."

The most compelling evidence that unions are being left behind is the steady decline in their membership. In the last four years, while the number of employed workers rose 5 percent, from 87 million to 91 million, union membership fell 13 percent, from 20 million to 17.4 million.

Union members now constitute only 18.8 percent of the U.S. work force, compared with 23 percent in 1980 and 35 percent in 1945. Unions' problems do not stop there.

Last year, well into a national recovery, union-negotiated wage gains were the lowest in more than a decade and were lower than gains among nonunion employes. The AFL-CIO's presidential candidate was buried in a landslide. The public strongly supported President Reagan's firing of 11,200 air controllers in 1981 for striking illegally, and since then unions' public esteem has sunk to an all-time low. Unions now are losing more employe representation elections than they win.

Several reasons are given for labor's decline: a continued shift in the nation's economy from manufacturing, where unions traditionally have been concentrated, to service industries, where unions have scarcely penetrated; a shift of jobs from Northern states, where unions are strong, to sun belt states, where unions are weaker; an increasing willingness of employers to contest unionization of their employes; and a shift in public attitudes about work, unions and union membership.

AFL-CIO President Lane Kirkland said, in releasing the report to the organization by a committee of union presidents and academics, that unions must accept the fact that "this is a world that is increasingly mercantilistic; we live in a world in which capital is mobile and labor is not."

Kirkland said surveys show more than 30 million nonunion workers "would like" to be union members, but union attempts to organize them have to deal with "a toothless labor code" and "ferocious and subtle and sophisticated employer resistance."

Other observers say organized labor's biggest problem is internal. "I disagree with the theory that unions are going out of business," says John Tysse, partner in the Washington labor law firm of McGuiness & Williams, "because organized labor has always been a resilient institution. But there's got to be a change in union leadership. They need to convey a different image to the rank and file. Without slighting Lane Kirkland's intellectual capacity or abili-

PHOTO: ROBERT RATHE—FOLIO

PHOTO: JUDITH SLOAN

AFL-CIO officials like Howard Samuel are pondering strategies to win members in changing workplaces of the 1980s.

ty, I believe the image he projects is part of organized labor's problem.

"Unions need new strategies for organizing, especially among women workers. They have had very poor success in organizing women, partly due to the image the leadership conveys—the image of an arrogant, inflexible, male-dominated institution."

Howard Samuel, president of the AFL-CIO's industrial union department, agrees that attracting women is a major problem for unions. He says: "The economic recovery of the last two years added 8 million jobs in services, while 1 million jobs were lost in manufacturing. More than half those new jobs were filled by women, and we have not done a good job of organizing them. Other problems in those jobs are the increasing number of part-time workers and independent contractors and the higher rate of turnover."

The AFL-CIO report shows that by 1990, service industries will employ almost three quarters of the labor force. Yet less than 10 percent of the service sector is organized, and only 20 percent of the AFL-CIO membership is in unions of service workers.

Despite this obvious challenge to organized labor's future, another study shows unions have been spending far more organizing money trying to win members in manufacturing industries than in service industries.

And even in service industries, much of the organizing effort is in unions' competing against one another to sign up the same workers.

In California and Massachusetts, the Communications Workers are competing against the International Brotherhood of Electrical Workers for telephone employes.

In Ohio, the contest is between the Communications Workers and the American Federation of State, County and Municipal Employes for university service workers. In Florida the Teamsters are fighting with the Machinists for public employes. In some places four or five unions are going after the same work force.

The AFL-CIO, whose 96 affiliates include all the major unions except the Teamsters and the National Education Association, has rules against its unions "raiding" one another's memberships. But union mergers are another story.

IN LABOR CIRCLES, mergers between two unions are generally considered a good thing because they increase the economic effectiveness of each. Up to now the AFL-CIO has automatically approved all merger requests from its affiliates. But as more and more unions with dwindling memberships and shrinking revenues seek to bolster their cash and numbers through mergers, some of the marriages are turning out to be less than happy.

Ever since the boilermakers took over the cement workers last year, for example, there have been complaints

PHOTO: PHILLIP DAVIES—LIAISON

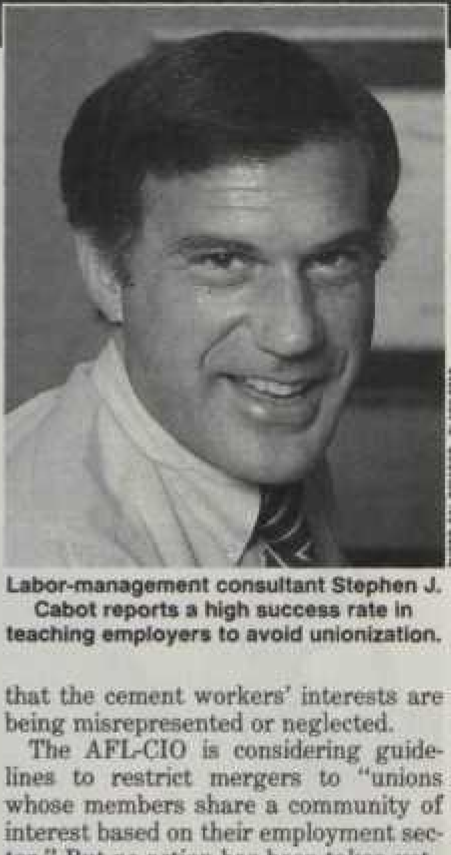

PHOTO: SAL DiMARCO—BLACK STAR

Labor-management consultant Stephen J. Cabot reports a high success rate in teaching employers to avoid unionization.

that the cement workers' interests are being misrepresented or neglected.

The AFL-CIO is considering guidelines to restrict mergers to "unions whose members share a community of interest based on their employment sector." But no action has been taken yet.

Overall union membership losses in the last few years would be even greater if it were not for offsetting gains among public employes. Legislatures and school boards have not resisted unionization as private employers have.

However, federal deficit-reduction measures have slowed the growth of public employment and wages. Public employe unions are being confronted with economic pressures like those that have resulted in contract concessions among private sector unions. This year in several parts of the country blue collar federal workers, whose pay is tied to prevailing private sector rates, have had their wages reduced. And white collar workers face an across-the board pay cut if Congress accepts President Reagan's recommendation.

In the private sector, unions increasingly are pursuing a "corporate" organizing strategy that has yielded some successes in recent years. In these coordinated campaigns, one or more unions exert pressure on a large employer's customers, its suppliers, its banks and the public to force the company to deal with the unions.

Unions say their most successful campaigns have included those against the J.P. Stevens textile company, Litton Industries and the Beverly Enterprises nursing care chain. The Armour Food Company may be next, unions say.

The AFL-CIO's Samuel says corporate campaigns have resulted in 60 percent successes for unions in employe elections, compared with 45 percent generally.

He says coordinated campaigns are a response to the increasing effectiveness of employer opposition.

"In the 1960s, when a union took aim at a company, if you were a betting man you would bet on the union to win," he says. "Today that's changed. Now a betting man would have to get odds on the union."

The AFL-CIO report on labor's problems says that in most organizing efforts, "unions now face employers who are bent on avoiding unionization at all costs." It says "95 percent of employers actively resist unionization, and 75 percent of all employers hire so-called 'labor-management consultants' to guide their efforts to avoid unionization at an estimated cost of over $100 million annually."

Lawyer Tysse says organized labor overstates the role of labor consultants. "What consultants do for the most part," he says, "is give employers good, basic employe relations advice. They rely on the old saying that the only company that gets a union is a company that deserves a union. To portray consultants simply as 'union busters' misses the point that good employe relations is what keeps out unions."

Stephen J. Cabot, a prominent labor-management consultant whose national firm is headquartered in Philadelphia, says: "We spend 50 percent of our time counseling employers on how to maintain an involved work force. We tell them to concentrate on including their workers, getting their input, before decisions are made. We tell them to earn their employes' trust. And we estimate that our success rate in union represen-

PHOTO: SUSAN GREENWOOD—LIAISON

The AFL-CIO's President Lane Kirkland (right) with Robert Georgine, head of its building trades department. Unions' share of construction has contracted sharply.

tation elections is over 95 percent."

Small businesses generally are less unionized than large employers. Frank L. Mason, president of the Mason Corporation, an aluminum products manufacturer with 175 employes based in Birmingham, Ala., has not employed any labor-management consultants. But, he says, "we do not have a union. We feel if we do our job in management and address employes' needs and concerns, they won't need a union."

Richard Lyles, whose clients have included Hughes Aircraft Company, Exxon Research and the Australian Institute of Management, says unions now are suffering in part because of past success in promoting legislative protection for workers. He notes that workers now have legal guarantees of things like equal employment opportunity, pension protection and freedom from willful firing, for which they used to rely on unions and union contracts.

"Today a worker with a grievance would rather go to court and get punitive damages," he says. "It takes longer but the payoff is higher."

He says a new generation of business managers more sensitive to employe issues also has "dramatically increased the trust level of employes so they don't need the security blanket of unions any more."

He adds: "The bottom line with unions is like that at any other organization in trouble. The blame has to be laid at the door of the unions' management. They're not managed well. Unions have to look at a fundamental realignment of their purposes, because the needs they served no longer exist."

The AFL-CIO report makes some of the same points. It says that "we must expand our notions of what it is workers can do through their unions," arguing that workers want to participate more fully both in workplace decisions and in union affairs. It recommends new categories of membership for workers—many of them former union members—who are not covered by contracts.

The report says some organizing can be built around single issues like pay equity or the use of video terminals in offices. It urges unions to go after smaller businesses, rather than focusing just on major employers.

CAN ORGANIZED labor recover from its downward slide? Leo Perlis, retired AFL-CLO director of community services, says the unions first must modify their intransigence both toward business and toward the present national administration.

He recommends that AFL-CIO leaders take a "two-minute walk" from their Washington headquarters to the White House to seek a meeting to discuss "the rights and responsibilities of public employes."

Despite recent setbacks, AFL-CIO President Kirkland says he and his organization remain optimistic. He says the history of the labor movement has been full of reverses and predictions of disaster that failed to materialize.

Now the doomsayers are at it again, Kirkland says. "But when the vultures are circling, something mystical tells me that's when we are on the verge of revival and a resurgence of growth." NB

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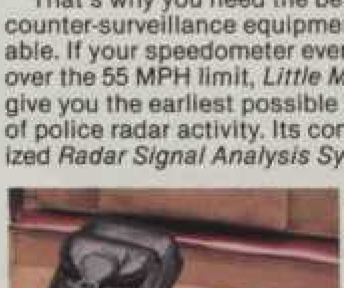

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CHANGE IN TAX LAW

Have Your Company And Sell It, Too

By John E. Hempstead

ILLUSTRATION: WILLIAM COULTER

FRED FRISBEE knew that his employes would be very upset if they learned that the visitor inspecting the plant represented Conglomeroid, a conglomerate that planned to buy Fred's company. So Fred told them the man was an insurance agent.

Fred would have done anything to avoid selling Dynasoar Electronics. He had founded it 35 years before and had watched it grow and prosper. The company was now worth about $5 million and represented most of his wealth.

But Fred had begun to worry that any reversal in Dynasoar's fortunes could cause a good portion of the value he had built up over the years to melt away. He was also concerned that his estate would not be liquid enough to pay estate taxes upon his death.

The man from Conglomeroid had told Fred he could solve his problems by selling Dynasoar. Fred agreed that this might solve his financial problems. But he hated to turn his company and his employes over to outsiders.

If Fred is lucky, before he signs on the dotted line with Conglomeroid someone will point out to him a little-noticed provision of the 1984 Tax Reform Act. That provision has begun to get a lot of attention from shareholders of closely held companies.

It is a change in the law governing employe stock ownership plans. (An ESOP is an employe retirement plan designed specifically to invest in the stock of the employer company.) The change creates a new kind of financial transaction known as the "tax-free rollover." A tax-free rollover would allow Fred to solve his estate problems without selling out to anyone.

In brief, a tax-free rollover permits a shareholder of a closely held company to sell some or all of his stock in the company to a company-sponsored ESOP for cash—thereby achieving liquidity and diversifying his personal holdings—without paying federal income or capital gains taxes.

Here is how it can work. Assume that Fred owned 100 percent of Dynasoar Electronics' outstanding common stock and he wanted to put some portion of the $5 million value of his company, say $2 million, into a diversified portfolio of blue-chip securities. He would take these steps:

1. He would have Dynasoar Electronics set up an ESOP, if it did not already have one.

2. He would have the ESOP borrow $2 million from a bank. The loan would probably be guaranteed by Dynasoar.

3. He would sell 40 percent of his Dynasoar stock to the ESOP for the $2 million in cash that the ESOP had borrowed from the bank.

PROVIDED that, within 12 months, Fred reinvested the $2 million in securities of U.S. corporations, he would pay no federal taxes on the transaction. For capital gains purposes, the new securities would be held at the same cost basis as his original Dynasoar stock.

The bank loan taken out by ESOP would be paid off over a period of years from tax-deductible annual contributions by Dynasoar Electronics.

As the bank loan was paid off, shares of Dynasoar stock would be credited to the accounts of the Dynasoar employes participating in the ESOP.

In order for an owner to receive tax-free treatment on such a transaction, an ESOP must own at least 30 percent of the outstanding stock of the company upon the completion of the transaction. Neither the owner nor any member of his family employed by the company may receive shares that are distributed to employes after the owner has sold them to the ESOP.

Before creation of the tax-free rollover, virtually the only way an owner could achieve tax-free liquidity was by selling his company to an outsider. Now he can do it by selling part or all of his holdings to his employes.

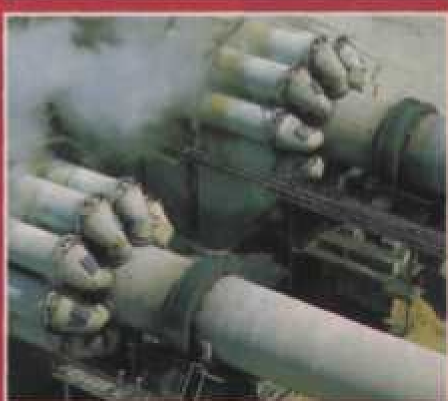
Congress did some other things in the 1984 Tax Act to make ESOPs more attractive. It changed the law to permit companies to take a tax deduction on dividends paid to employe-shareholders whose shares are held in an ESOP. It also gave a tax break to banks and other lenders making loans to ESOPs, permitting them to receive half the interest income on such loans tax-free.

Finally, the law was changed to permit the executor of an estate holding stock in a closely held company to shift and defer part of the estate tax burden by contributing the stock to an ESOP.

Tax-free rollovers have been available under the new law since July 19, 1984. Through them, Congress has created a wonderful opportunity for shareholders of closely held companies to gain tax-free liquidity. NB

JOHN E. HEMPSTEAD *is president of Hempstead & Company, a valuation and ESOP consulting firm based in Haddonfield, N.J.*

KOREA



Facets of a dynamic economy: Counterclockwise from the top are the Sunkyong Group's Sheraton Walker Hill Hotel, a huge kiln in a Ssangyong Group cement plant, research activity in a Dainong Group textile mill and models of a new Hyundai Business Group car to be sold in the United States.

Free Trade Views In The Land of a Miracle

Shipbuilding and textiles play large roles in Korea. At left: a Daewoo Group shipyard. Above: the Kolon Group's high-quality fabric, Hipora.

HOW DO YOU fashion an economic miracle in a country with limited natural resources? Start with a highly educated and hard-working work force, a boot-strapping philosophy and a do-it-yourself attitude. Plus a national willingness to give up things today to achieve a higher standard of living tomorrow.

A leading Korean businessman, Woo Choong Kim, told a group of Harvard Business School students recently that for a developing country to get the growth needed to catch up with industrialized nations, a generation must be sacrificed.

"We feel that we are the one Korean generation to be sacrificed to attain that growth," said Kim, chairman of the Daewoo Group, one of the largest conglomerates in the Republic of Korea.

Growth already has been phenomenal. In 1984 the ROK gross national product was more than $80 billion, a 22-fold boost in 20 years. The Korean Development Institute predicts the GNP will rise to $250 billion by the year 2000 while the population will grow from 40 million to 50 million.

KDI concludes that the Republic of Korea at the turn of the next century will be the 15th largest economic power and among the top 10 trading nations.

The so-called Korean Miracle, business leaders say, has finished its first stage, and the second stage is only beginning. Not until that stage is finished—sometime in the middle of the 1990s—can Korea be regarded as one of the developed countries.

Business leaders contend that until then it is unfair to deny the Koreans trade preferences under the GSP—Generalized Systems of Preferences.

When Americans start comparing the Republic of Korea on an equal basis with Japan, Korean business leaders object. They point out that the Korean economy is one fifteenth the size of the Japanese. Per capita income in the ROK is barely one fifth that of Japan.

In 1984 the United States posted a $36.5 billion negative balance of trade with Japan. For the first time in history, it also had a negative balance with the Republic of Korea: $3.5 billion. Sales of "invisibles"—services—and interest payments on some $43 billion in foreign debt actually brought trade into near balance for the year, however.

Trade between the Republic of Korea and the United States amounted to approximately $16.5 billion in 1984, making the ROK the seventh largest market for U.S. exports—and the fourth largest for U.S. agricultural products, in particular. ROK imports from the United States totaled $6.5 billion during the year.

A healthy export trade is the cornerstone of the Korean economy. One third of the GNP comes from exports, compared with 7 percent for the United States. Main exports to the United States are textiles, electronic goods, steel products and footwear.

The growing protectionist mood in America is a major concern of Korean business because one third of the nation's exports are to the United States.

Protectionism

Jong Hyon Chey, chairman of Sunkyong Ltd., observes: "In the 1950s and 1960s trade was very open in the United States. We found many free traders. But as the Japanese made more penetration in U.S. markets, such as automobiles, steel and electronics, the United States became more concerned about protecting U.S industries. By 1980 the situation had become very serious, just as we were trying to get into the U.S. market."

Chey, whose group of companies developed and is the sole Korean producer of such sophisticated products as videotape and floppy disks for computers, is well qualified to understand both the Korean and U.S. viewpoints. He has a chemistry degree from the University of Wisconsin and a master's in economics from the University of Chicago.

Kyung Hoon Lee, president of Daewoo Heavy Industries, Ltd., a major company in the Daewoo group, observes that quotas and so-called voluntary restraints that are limiting exports to a percentage of historical levels are unfair to U.S. consumers and Koreans, because Korean industries are just beginning to emerge, and their historical levels are small.

"These quotas and voluntary restraints, in effect, protect the market share of well-established exporters in countries like Japan," Lee says. "I find it ironic that the United States is, in effect, penalizing Korean industry while protecting Japan.

"If quotas are required, we would much prefer that Washington determine an import ceiling, then let foreign suppliers compete on the basis of price and quality. This would result in lower prices for American industry and consumers and allow industries in countries like Korea to grow."

Suk Won Kim, chairman of the Ssangyong Group, says: "Considering our strategic importance and trading volume, Korean products are facing unfair restrictive treatment from the U.S. government and industry."

In a recent speech to the American Chamber of Commerce in Korea, Chul Su Kim, assistant vice minister for trade and industry, said that to U.S. business

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people, a recent flurry of antidumping and countervailing duty investigations involving Korean imports might mean evidence of unfair trade practices, but to Koreans the trend "is more readily explained as a trade harassment tactic."

Soo Chang Chung, president of the Korea Chamber of Commerce and Industry, an organization that represents all Korean businesses, explains: "Once a case is filed, foreign suppliers suffer greatly regardless of the final outcome. Antidumping and countervailing suits often take more than a year to settle, resulting in high legal fees and other costs.

"Furthermore, foreign suppliers experience reduced sales, because buyers are discouraged by the uncertainty of future price and availability of the product while the suit is in progress. To date, no compensation has been paid for these losses, even in cases where no dumping or subsidy has been found."

A cooperative Korean attitude, Assistant Vice Minister Kim says, is reflected in the recent steel controversy. As a result of a lengthy conference, the Republic of Korea voluntarily agreed to limit its steel exports to the United States to the level of 1.9 percent of American domestic consumption, down from the 2.4 percent market share Korean steelmakers had enjoyed.

Access for U.S. Firms

While Korean business leaders worry about access to the U.S. market, U.S. business people are concerned about access to the Korean domestic market. That concern, however, does not always take into account measured changes in the ROK to liberalize trade.

Although the government has not abandoned its policy of protecting infant industries from foreign competition, it has signaled that it will not be bailing out more mature firms in the future.

In the past the government has constructed a safety net under businesses and essentially reserved the domestic market for Korean products. But in February it declined to rescue the financially troubled Kukje Group, a large conglomerate. Banks involved began selling off the various companies.

Also, the government has increased the ratio of foreign products that can be imported without prior official approval from 54 percent to 85 percent this year. By 1988 this will rise to 95 percent. In comparison, the average level in developed countries is 92 percent.

American business people in Korea grumble that, at the same time, the government is raising tariffs. Yonghak Park, chairman of the Dainong Group, contends that this is not a valid complaint,

especially today. "More than any other country, Korea is reducing tariffs while liberalizing imports," he says, pointing out that this is in sharp contrast to Japan.

"We have no intention of imitating Japanese economic policies," says Dong Chan Lee, chairman of Kolon Industries, Inc.

The Korean tariff structure is undergoing major reform. The government has set norms it expects to reach by 1988 of 5-10 percent for raw materials, 20 percent for intermediate goods and 20-30 percent for final goods. The average nominal tariff rate for manufactured goods will decline from 22.6 percent in 1983 to 16.9 percent in 1988.

Sunkyong's Chairman Chey says: "The situation is improving. Access is much easier now than a year ago and even more easy than five years ago. I think the same will apply to services in the near future. On the other hand, U.S. business should be more aggressive in trying to access the Korean market."

Ssangyong Group Chairman Kim contends that the Republic of Korea is more open than Japan is, but he says that the domestic ROK market at this stage of the nation's development is small in comparison with Japan's. Until the ROK economy develops to the Western European level, he says, "we cannot afford to import U.S. products and services to the satisfaction of U.S. industry."

If all goes according to schedule, the Korean domestic market will be at least as open as that of any developed country by the time the torch enters the Olympic Stadium in Seoul for the 1988 Summer Olympics. As the Korea Chamber of Commerce and Industry predicts, the Korean market will be internationalized.

Investment

While U.S. investment in Korea has been notable, and there is growing interest in joint ventures, a relatively new development is Korean investment in the United States.

According to the Heritage Foundation's Asian Studies Center, in the past five years Koreans have invested $150 million in the United States, building factories and creating jobs for Americans.

Hyundai, Lucky-Goldstar and Samsung have established electronics firms in the United States that produce a variety of products such as memory chips, televisions and microwave ovens.

Domestically, there is increased activity that is being reflected in U.S. investment. The current Republic of Korea five-year plan has development of high technology industries as a top priority. For example, there are four major manufacturers that produce or are planning to produce a variety of large and personal computers in arrangements with U.S. producers: Hyundai (IBM); Lucky-Goldstar (AT&T); Samsung (Hewlett-Packard); and Daewoo (Micro Soft Company of the United States as well as NEC Corporation of Japan).

Those Korean manufacturers, envisioning an export market by 1990, are investing in the United States, specifically in Northern California's Silicon Valley, to acquire chip technology and manufacturing expertise.

One of the largest investments thus far has been by the Hyundai Group,

which spent $35 million to establish Hyundai Electronics of America in 1983. Located in Santa Clara, Calif., the firm has a 120,000-square foot facility that employs some 200 Americans. Hyundai Electronics manufactures 16k static random access memory chips, microprocessors and large-scale integrated circuits. By the end of this year a total of $50 million will have been invested.

Daewoo, though it has yet to establish a U.S. electronics firm, was the initial financial backer for ID Focus, of Santa Clara. Daewoo invested $2 million in this small, independent firm, staffed almost entirely by Americans. ID Focus currently is conducting market research and industrial design on 20 electronics projects for Daewoo.

Autos

On the horizon are more Korean investments in the United States—this time involving automobiles.

Hyundai, Korea's largest auto maker, plans to introduce a new subcompact called the Pony XL into the United States during the 1986 model year. It may also introduce the Stella, a medium-sized auto. The Pony XL is a front-wheel-drive auto powered by an engine in the 1,200-1,400 cc range. The original Pony, a Korean-designed auto, was introduced in 1976 by Hyundai.

"Hyundai Motor Company will establish a U.S. company to market the autos and to develop a dealership network," says Yung Wook Park, president of Hyundai Corporation, the group's trading company.

Park adds that the U.S. venture, which has set an initial goal of importing 100,000 autos annually, will create a large number of jobs in the United States and will not be competing with American auto makers, who do not make cars of the same size.

"We will want to purchase components from the United States not only for our own cars, but possibly to export to other countries," Park says.

Hyundai now exports versions of the Pony to 65 countries, including Canada, from which the Korean manufacturer also imports component parts and raw materials. Sales figures at the start of 1985 showed the Pony was the second best selling import in Canada.

"Canadian manufacturers, like Canadian consumers, are very happy with this arrangement, and we are eager to do the same thing in the United States," says Park.

While Hyundai will go it alone in marketing in the United States, Daewoo will team up with General Motors in a 50-50 joint venture to produce in Korea a subcompact based on the West German Opel Kadett. The subcompact will be front-wheel drive, with an engine capacity of 1,500-1,600 cc.

"The new car—called a T car—which we will begin manufacturing in late 1986 with General Motors, will be sold in North America as one of the Pontiac line of cars," says Daewoo Heavy Industries Ltd. President Lee.

"We believe that joint venture partnerships with American companies, to

PHOTO: DAVID BURNETT—WOODFIN CAMP

Koreans are willing to work hard—and they are good at what they do.

which we bring a Korean manufacturing base, benefit both U.S. and Korean interests. The T car, for example, will allow GM to remain competitive in a segment of the North American market for which it is unable to produce a competitive vehicle in its U.S. plants."

Increasingly, Korean companies are thinking of more joint ventures with American firms. Sunkyong Chairman Chey, for example, says that his group of companies "is very receptive to U.S. investment. We look for any feasible project."

Frederick C. Krause, executive vice president of the American Chamber of Commerce in Korea, says: "We do have many fine joint ventures in South Korea, and some have been quite profitable. There have been some problems, but on balance U.S. investments in the country have been relatively successful."

Krause believes that changes in the investment law that took effect last July have been a positive step. A major change has been to cut down on bureaucratic roadblocks. Automatic government approval now will be given to proposed foreign investment in 651 of 999 designated industrial sectors. The government retains prior approval authority on the remaining sectors, which largely comprise projects carried out by the government, public utilities and defense-related industries.

Revisions of the investment law also allow 100 percent foreign ownership for the first time. In the past the focus has been on joint ventures, with Koreans holding 51 percent of the venture.

Also new is a change that will be attractive to small investors. Automatic approval will be given for foreign equity investments of less than $1 million, providing that the sector involved is not on the "negative list" and that the foreign partner owns less than 50 percent of the venture. If the foreign partner wants a share greater than 50 percent, either more than 60 percent of the product must be exported or the current Korean tariff rate on such products must be less than 10 percent.

In the first half of last year, foreign investment in the Republic of Korea was up 319 percent over the same period in 1983. U.S. ventures accounted for 43.5 percent of all foreign investment during the period—in which, for the first time, the United States passed Japan as the leading investor in Korea.

In response to complaints about copyright, patent and trademark protection, the government is trying to correct deficiencies.

"Korea is very interested in the transfer of technology from the advanced nations," says Dainong Group Chairman Park, "but these nations have a tendency to avoid the transfers because they fear a boomerang effect. So solving this problem is one of our most pressing matters."

For Americans contemplating the Korean market, the AmCham's Krause has this advice: "Doing business in Korea is different than in probably any other nation in Asia, and the prudent businessman has to educate himself on the differences. Do research and study to keep from missing some turns in the road."

Says Kolon Industries Chairman Lee: "There are a lot of foreign companies in Korea that have achieved successful results through continuous investment here."

As the Republic of Korea launches its second great leap toward its goal of becoming an industrialized nation, it faces tough competition in world markets. But history has already proven that Koreans are as smart, adaptable and innovative as anyone else. And they have another trait that sets them apart. It is hard—perhaps impossible—to find people who work harder. NB

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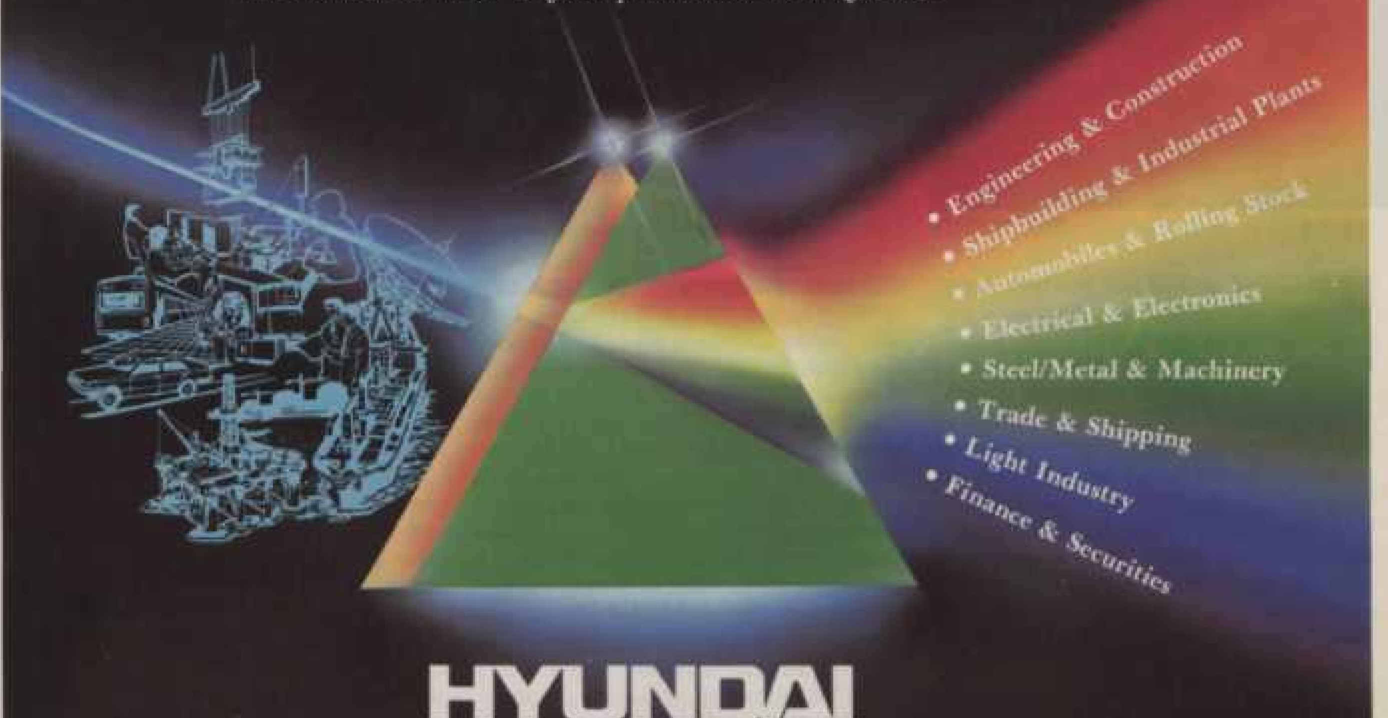

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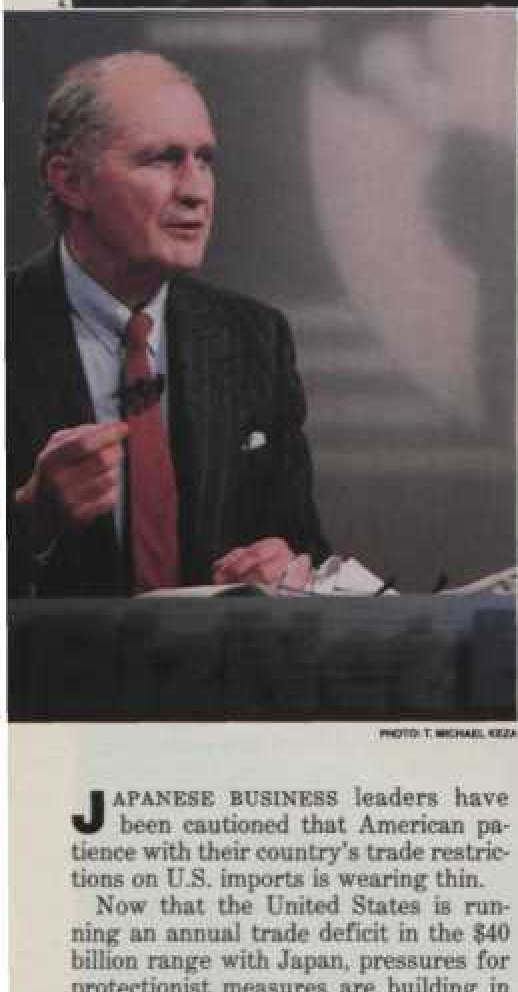


PHOTO: T. MICHAEL KEZA

Exports to Japan: An Open or Shut Case

Sharply divergent views are aired in an international videoconference.

By Henry Eason

JAPANESE BUSINESS leaders have been cautioned that American patience with their country's trade restrictions on U.S. imports is wearing thin.

Now that the United States is running an annual trade deficit in the $40 billion range with Japan, pressures for protectionist measures are building in Congress, the executives were told.

In turn, the Japanese held that the trade deficit does not stem from limits imposed by Japan, but rather from the strength of the U.S. dollar, U.S. manufacturers' difficulties in meeting Japanese consumer needs and strong American demand for Japanese products.

The sharp exchange of views occurred in an international videoconference produced by BizNet (American Business Network), television operation of the U.S. Chamber of Commerce, for NATION'S BUSINESS.

Featured were key U.S. policymakers on trade issues, American business leaders and Ambassador Yoshihiro Okawara of Japan in the BizNet studios in Washington, and, in Tokyo, top Japanese business executives, U.S. Chamber officials and U.S. Ambassador Mike Mansfield.

Speaking from Washington, U.S. Chamber Chairman Van P. Smith set the tone for the debate with this declaration: "Rightly or wrongly, Americans are losing patience. Talk of drastic solutions to trade frictions grows." He also stressed a theme that won wide support throughout the discussion: "Our relationship is much too important to be undermined by specific trade irritations."

In the second such dialogue between Americans and Japanese, there was consensus on at least one point: Trade friction between the two political partners is at a historically high level. There was little agreement on solutions.

The Japanese maintained repeatedly that their markets are more open to American-made merchandise than U.S. business people think. They said the strong dollar, by making goods from the United States costly for Japanese consumers, is the chief culprit, and the solution is reduced U.S. federal budget deficits.

THE AMERICANS hammered away at Japanese restrictions on imports in the telecommunications, forest products, petrochemical, pharmaceutical, medical and agricultural fields.

Yoshihiro Inayama, chairman of Japan's Keidanren—like the U.S. Chamber a major federation of business people—underscored Smith's point that greater understanding must be achieved. "We would not like to see the current causes for concern or frustration lead to protective measures by the United States and therefore to a new gap between the two countries," he said.

Commerce Secretary Malcolm Bal-

PHOTO: CHAMBER OF COMMERCE OF THE UNITED STATES

Commerce Secretary Baldrige, at far left, makes a point at the BizNet studios in Washington. Upper left: Baldrige with Ambassador Okawara, Sen. Heinz, Chamber Chairman Smith and Rep. Gibbons. Under a banner in Tokyo: President Sekimoto of NEC, Chairman Morita of Sony, Chamber President Lesher and Group Vice President Grant, Chairman Inayama of Keidanren, Ambassador Mansfield, Chairman Matzuzawa of Fuji Bank Ltd. and President Yahiro of Mitsui & Company.

drige said Japan is itself practicing protectionism. "We are looking at a much more closed market than in other trading countries of your size," he said.

Countering, Ambassador Okawara, who has since completed his tour of duty in Washington, said: "United States exports to Japan are growing, despite phenomenal restraints of the dollar. In 1984, American exports went up 7.6 percent."

From Tokyo, Ambassador Mansfield said the trade outlook between the two countries is "precarious," but both share responsibility for the situation. He conceded that the strong dollar hurts American exports but insisted that the Japanese should give American businesses the same opportunities they accord their own firms.

Chamber President Richard Lesher, summing up the view from both sides of the Pacific, said: "This is a critical time in the history of trade between our two nations. Economic growth and prosperity can flourish, but only if we can make substantial progress toward resolving these differences. It's time to commit ourselves to solving these problems."

Early in the program, House trade subcommittee Chairman Sam Gibbons (D-Fla.) jokingly observed that American participants in the show were viewing Japanese participants on Sony-made televisions.

NEC Corporation President Tadahiro Sekimoto, smiling, conceded the point, but added that the program was being transmitted via American-made Intelsat satellites. And Akio Morita, chairman of Sony Corporation, said: "That

Southern Hospitality for Japanese Firms

Alabama and Tennessee, states that sponsored the Japan-U.S. videoconference, have in recent years rolled out the welcome mat for Japanese companies and formed strong two-way relationships with Japan. By making Japanese investments in their states attractive, they have provided jobs for their people and helped cut down on bilateral trade friction.

Alabama Gov. George Wallace says: "We offer 100 percent industrial revenue bond financing for land, buildings and equipment. Alabama has abundant energy, electrical power generated by hydroelectric plants, nuclear reactors and coal-fired steam plants."

Wallace observes that his state allocates a greater portion of its tax revenue to education than any other state in America: "Alabama serves new industry with the nation's best industrial training program, with mobile units on location where the people will actually be working."

Alabamians, he notes with pride, "developed the technology that put a man on the moon."

Tennessee, says Gov. Lamar Alexander, is the home of more than 28 Japanese corporations, companies that have invested more than $1.1 billion in their operations in his state, providing some 6,700 jobs for Tennesseans. By early 1985, the state had attracted 12 percent of all Japanese manufacturing investment in the United States.

"This large and growing Japanese investment in Tennessee," says Alexander, "is a tribute to the productivity of our work force, the quality of products that are 'Made in Tennessee' and the livability enjoyed by our citizens. It recognizes, too, Tennessee's superb location."

For more information on investment opportunities in these states, write the Alabama Development Office, Industrial Development Division, State Capitol, Montgomery, Ala. 36130, or call (205) 832-6980 or telex 593-458; and write the State of Tennessee Department of Economic and Community Development, 1016 Andrew Jackson Building, Nashville, Tenn. 37219, or telex 499-1829 ECD NAS.

Sony television is made in the United States, every part of it."

"It seems all you want is our raw materials," said Gibbons, and consequently, protectionist pressure on Capitol Hill is "huge and growing."

Gibbons, the free-trading head of the powerful Ways and Means Committee's trade panel, observed that last year's omnibus trade bill excluded many protectionist features proposed by members of Congress from states with industries hurt by Japanese imports. But pressure as the result of Japan's year-end surplus, he said, "could trigger various protective measures." Lawmakers from import-injured areas are "becoming hard to manage" in Congress, he stressed, because the huge Japanese surplus is causing "festering problems."

Sony's Marita said that "the most efficient way" to reduce the trade imbalance "is to transfer our plants to the United States. Many corporations have begun production in the United States, employing American workers and using American materials."

Baldrige welcomed Japanese investment in the United States: "It provides Americans jobs and reduces Japanese exports to some extent." But, he added, "it does not have any beneficial effect on the U.S. companies that are trying to export to Japan and are kept out by trade barriers."

AMERICANS CITED statistics to illustrate their point that, despite Japan's claims that it has lowered protective walls, it still appears to discriminate against foreign goods—America's or any other nation's.

In 1970, said Gibbons, only 10 percent of all goods consumed in Japan were foreign. In 1983 the figure was 13 percent. Meanwhile, the comparable figure in the United States went from 11 percent to 24 percent.

Sen. John Heinz (R-Pa.), a leading trade expert, said bluntly: "People don't understand how a great country like Japan can be the last industrialized country in the world with a closed market. They get upset with U.S.-Japanese trade being a one-way street." South Korea and West Germany, two other major Japanese trading partners, are similarly frustrated, he said.

Calling Japan protectionist, Heinz, chairman of the Banking Committee's subcommittee on international finance and monetary policy, said, "Japan adopts policies you might expect from the weakest, least advantaged, least educated and least skilled of the least developed nations."

Fuji Bank Chairman Takuji Matsuzawa conceded that "we have to cut down on our dependence on exports by creating stronger and growing internal demands" for imports.

Often, suggested Mitsui & Company President Toshikuni Yahiro, American exporters give up too soon in trying to crack Japanese markets. "You have to make a very detailed, meticulous study of the sentiments and likes of the Japanese consumers," he said. "You cannot expect, simply because a product is popular in the United States, that it is going to be as popular in Japan. When we export, the first thing we do is market research.

"You have a big domestic market," Yahiro continued, "so you didn't have to worry for many years about exports. In contrast, Japanese have been living for many years on imports and export activities. You should become more export-minded."

If American businesses work harder to adapt to Japanese consumers' tastes, Yahiro predicted, "the slightly stronger dollar will be no hindrance."

In January, President Ronald Reagan and Prime Minister Yasuhiro Nakasone agreed, at least on a broad level, that trade between the two countries should be freer. Since then, however, talks at lower government levels have bogged down over specifics of reducing Japanese administrative impediments to open markets.

Heinz asked: "How are we ever going to be sure that bureaucrats in the Japanese government or powerful private special economic interests do not frustrate the good intentions of Prime Minister Nakasone and do not stain the honor sacred to the Japanese people?"

Yahiro acknowledged that Japan, like other countries, must work through many obstacles to implement change and emphasized that change also comes incrementally.

He observed that Japan's big trading companies are working hard to bring foreign goods to Japanese consumers and therefore are an important force for free trade. Nine of the biggest trading companies operating in the United States, he said, are directly responsible for the sale of over $8 billion in American-made products to Japan.

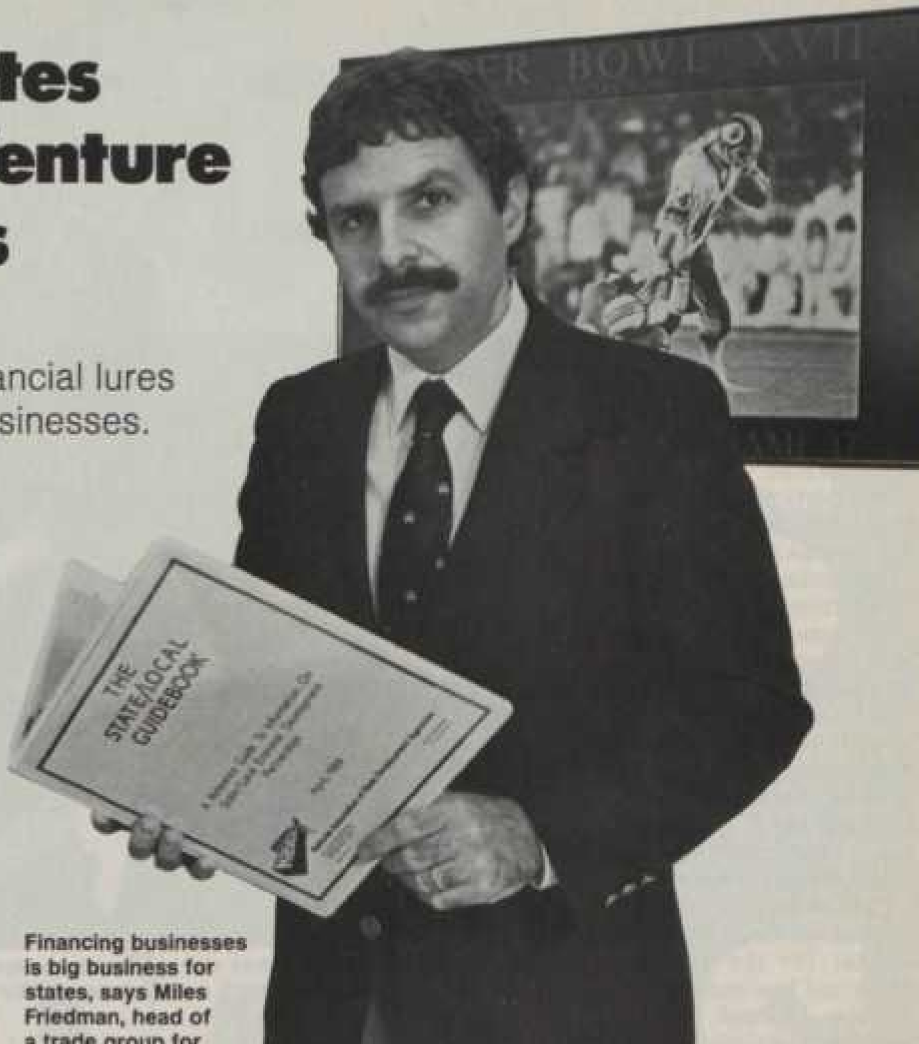
Sony's Morita suggested that Baldrige, who had complained that Japan's telecommunications market is shut to Americans, find out why so many Japanese telecommunications goods are sold in the United States. He indicated the answer would explain why U.S. telecommunications goods are not selling well in Japan.

Fuji Bank's Matsuzawa said Japan's overall tariff rate is 3 percent, against 4 percent for the United States. "There is a gap in perception," he added.

Inayama of Keidanren and Lesher of the U.S. Chamber concluded that the videoconference had gone far toward increasing understanding of the trade problems between two mighty economic powers. NB

When States Become Venture Capitalists

They're using new financial lures to keep and attract businesses.



Financing businesses is big business for states, says Miles Friedman, head of a trade group for state development.

PHOTO: T. MICHAEL KEZA

STATES ONCE tried to keep or attract businesses by offering tax incentives or streamlining licensing and location procedures. Now they are taking the next step by providing capital to promote entrepreneurial activity.

New Hampshire has created the Venture Capital Network to match investors and entrepreneurs. Maine and Massachusetts have created venture capital corporations. Hawaii has a capital loan program for plant construction, conversion and expansion.

"More and more states are realizing that the way to gain stability in their economic base is to create jobs within the state and nurture those already there through financial and management assistance," says Miles Friedman, executive director of the National Association of State Development Agencies. Every state is making the expansion and retention of business a top priority, Friedman says. And small business, which creates jobs, gets the most attention.

States are using a variety of financial incentives to foster economic growth:

Industrial revenue bonds are the most widely used. State and local agencies issue these bonds—selling them to private and public investors—and use the proceeds to construct or expand plants or other facilities. These plants are then leased to companies for the life of the bonds (15–25 years). When the leases expire, the companies can usually buy the plants for nominal amounts.

Almost half the states provide direct loan programs through which businesses can apply for below-market-rate financing.

Several states offer loan guarantee programs or interest subsidies to help businesses obtain lower interest rates on private loans.

Many states have set up privately operated development banks. These business development corporations sell their stock to large companies or banks in the state or are given bank lines of credit. In turn, the corporations make loans, primarily to small businesses, for working capital or expansion.

Beyond these widely used methods, individual states have come up with other creative financing techniques.

New Hampshire was inspired to create the Venture Capital Network by studies showing that the process by which entrepreneurs and so-called informal investors find each other is both haphazard and inefficient.

Informal investors—wealthy individuals who invest capital and experience in ventures—represent the largest pool of risk capital in the country and finance perhaps five times as many ventures as the public equity markets and professional venture capitalists combined, according to William Wetzel, Jr., a University of New Hampshire business school professor who researched the informal investor market.

The Venture Capital Network is a computerized data base that will get these investors together with entrepreneurs who need between $20,000 and $500,000 to launch innovative projects. William Osgood, director of the University of New Hampshire office of small business programs, says these informal investors generally look for "technology, invention and manufacturing" projects, and favor companies with the potential to grow into $5 million or $10 million businesses within five years.

Still in its infancy, VCN will accept out-of-state investors and entrepreneurs. For instance, a Maine investor might finance a Connecticut business. But James Hoeveler, network executive secretary, says that "the probability that the company will be in New Hampshire is fairly high." Hoeveler adds that once the network has made a compatible match between the investor and entrepreneur and introduced both parties, it "steps aside from any further negotiations." VCN requires a $100 annual subscription fee from entrepreneurs to keep their applications in the data bank. The application is updated every six months.

MASSACHUSETTS provides a bevy of financial assistance options to small business. A venture capital firm, the Massachusetts Community Development Finance Corporation, was started in 1978 with $10 million of state funds. It is now investing about $2.5 million annually and has $9 million invested so far. Approximately 75 per-

cent of its funds go toward expansions and relocations of existing firms; the remainder is for start-ups.

The company generally provides up to one third of the financing a business is looking for—on the average, about $300,000.

One of the firm's criteria, according to investment officer Nancy Nye, is that the business be located in certain target areas within the state—areas that have physically deteriorated infrastructures, particulary high unemployment and large low-income populations.

In exchange for some relief from very high tax rates, nine state life insurance companies formed a 25-year private partnership, the Massachusetts Capital Resource Corporation, with $100 million to provide funding to fast-growing small companies that cannot go the traditional financing routes.

"We're a source of more permanent, long-term debt capital for the smaller firms and less exciting industries spurned by the venture capitalists and the riskier, high tech companies avoided by banks and insurance firms," says President Bill Torpey.

The corporation does most of its investing in established businesses. It will provide loans as low as $100,000 or as high as $5 million, says Torpey, but is most comfortable in the $500,000 to $2 million range.

The grandfather of Massachusetts financing mechanisms is the Business Development Corporation, created by the state legislature in 1953 and run as a private corporation. Approximately 110 financial institutions within the state provide the bulk of the corporation's funds.

"We are primarily a lending, not a venture capital operation," notes Vice President Barry Wood. "We are a secondary source of financing and an adjunct to the banks, not a competitor. We'll get involved in financing—in the form of working and expansion capital—that the banks send over to us."

Though the corporation does not finance start-ups and bailouts, it has laid down a goodly portion of its money on leveraged buyouts, where a group of managers and investors pledge a business' assets as collateral for a loan to purchase the business. "Many times, national companies have divisions within our state which they feel are not compatible with their basic strategy and so want to engineer a divestiture of these subsidiaries," Wood explains. "We, on the other hand, want to retain the jobs that those divisions represent. Over the last three years, between 40 and 50 percent of our loans have gone in part to finance leveraged buyouts."

Another financing tool is the Massachusetts Technology Development Corporation. A commonwealth-created public corporation funded with $2 million of federal money, it provides loans and investment capital to high tech business start-ups in collaboration with private sources.

PHOTO: BRUCE FLYNN—PICTURE GROUP

Venture Capital Network matches entrepreneurs and investors, say staff member James Hoeveler (left) and Professor William Wetzel, Jr.

Alaska has shown some flair in its financial programs. Its Small Business Revolving Loan Fund makes 15-year loans at 9.5 percent interest for a maximum of $500,000 to small firms having fewer than 200 employes and grossing less than $10 million.

The state has also created the Alaska Renewable Resources Corporation, a public corporation that uses proceeds from mineral leases, rentals and royalties to finance start-ups and existing companies in forest products, fishing, agriculture and renewable energy resources. Financing is available in various forms, including loans, equity investments and direct grants.

Alaska's Small Business Office will aid start-up entrepreneurs in selecting sites, preparing business plans and lining up supply sources. It will also provide management assistance.

The Connecticut Product Development Corporation provides venture capital from state and federal funds for development of new products (it does not fund start-ups). Generally, the corporation puts up 60 percent of product development costs, and the small business the remainder. The corporation receives royalty payments on the new products.

Taking a cue from Massachusetts, the Maine Capital Corporation is a state-backed venture capital firm that aids start-ups and existing businesses. Meanwhile, the Maine Development Foundation provides site selection and trade development assistance to businesses.

Some 30 states are part of the Small Business Revitalization Program, a federal, state and private-sector partnership in existence since 1982. The program provides long-term, fixed-rate debt capital to small businesses that may want to expand or modernize.

Under the program, the states' governors work with private lending institutions within their states to make loan money—from $50 million to $250 million, depending on the state—available to growing businesses through the Small Business Administration and Housing and Urban Development Department.

In less than two years, the SBR effort has assembled loans totaling well over $1 billion for more than 800 businesses and industrial projects, resulting in more than 50,000 permanent jobs.

This is a representative sampling of what states are doing to keep business alive and well within their borders. Far from forsaking business, states are pumping money into new and existing companies at a fast and furious rate.

States are wising up these days, notes Friedman of the National Association of State Development Agencies: "They are very cognizant of the fact that if they don't pay attention to in-state firms, these companies can easily go out the back door as new ones are coming in." NB

—Mary-Margaret Wantuck

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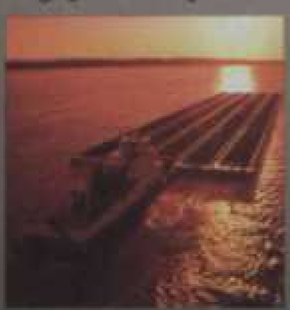

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Tug-of-War on Tax Reform

WHEN FORMER Treasury Secretary Donald T. Regan unveiled his department's tax reform proposal last November, he said it was "written on a word processor." With that, the administration signaled readiness to negotiate its plan to overhaul the tax code before the proposal goes up to Capitol Hill.

Those negotiations have begun. Pressure is coming from two directions: head on and from the inside. Many business executives, tax lawyers and lobbyists are pouring their opinions into friendly ears within the administration.

Investment would suffer, critics say, if Treasury's plan to ax investment tax credits and accelerated depreciation is adopted.

Others are trooping straight to the door of Treasury Secretary James A. Baker III.

Meanwhile, officials at the departments of Agriculture, Commerce, Energy and Interior and the U.S. Trade Representative's office, to name a few, have obliged by telling Treasury what they think about its reform proposal. Most do not like having to give up a host of tax preferences their constituents want. But none say that they are arguing about whether tax reform itself is good or bad.

As the consummate negotiator, Baker is saying little about what he wants in what will become the President's tax reform package when it hits the street in May. A virtual news blackout is keeping everyone guessing. That strategy, the lobbyists say, buys more time for Baker to cut a deal—one that can survive the trip to Capitol Hill.

Some companies are having a hard time trying to figure out whether their return on investment will go up or down under the Treasury proposal. Why is that so? Because it is not easy calculating the effect of axing the investment tax credit and stretching out the depreciation schedules, while simultaneously reducing the corporate tax rate; indexing depreciation, interest and capital gains for inflation; allowing for the partial deductibility of dividends; and changing the tax treatment of capital gains.

Manufacturers that invest in long-lived equipment say they will be hurt by the so-called real cost recovery system Treasury proposes. They like being able to generate cash internally faster than their equipment produces income.

No wonder. A Treasury study reveals that at today's low inflation rate, the investment tax credit and accelerated cost recovery system actually subsidize some companies' investments in machinery.

But many fast-growing companies that do not have much net income, or whose assets become obsolete more rapidly, do not get as generous benefits. Many of them like aspects of the Treasury proposal.

Companies are not all that excited about having the corporate tax rate cut from 46 percent to 35 percent. Why? Because many industries' effective tax rates are already below the statutory rate. How far below can depend on the inflation rate and quirks in the tax code.

AUTO MAKERS, according to Treasury's numbers crunchers, pay taxes at a real rate of 8 percent—because of the benefits of accelerated depreciation and the investment tax credit—for equity-financed equipment when the inflation rate is 5 percent. But when inflation doubles, that rate jumps to 26 percent, as the depreciation benefit erodes. Service firms pay taxes at a 31 percent rate on equity-financed equipment when inflation is 5 percent; when inflation doubles, the rate goes to 40 percent.

Treasury says its proposal would make the tax code more neutral and do away with many of the present system's biases—those that discriminate on the basis of asset life, industry and inflation. Still, the Treasury proposal would raise revenues from corporate taxes by an estimated $22 billion next year.

On the other hand, John Makin, an American Enterprise Institute economist, says that tax reform makes good sense. He says that Treasury's reform proposals are worth between $400 billion and $500 billion to the economy. That amount is the present value of the benefits that would come from a more efficient allocation of scarce capital. "How you get there, though, is a real sticky problem," he says.

Critics of Treasury's proposal are crying foul. They claim that the tax code was never intended to be neutral. Senate Finance Committee Chairman Robert Packwood (R-Ore.) agrees. He says the tax code can be the most efficient way of achieving desirable social and economic goals.

As for complaints that the tax code is an industrial policy in disguise, one that benefits industrial America with generous allowances for asset depreciation, manufacturers say that is what was intended when the administration's 1981 tax bill was enacted. To change the rules of the game drastically in the middle of play, they say, is not fair.

Faced with a potential political donnybrook involving all those who have something to lose from tax reform, Treasury's Baker may be searching for a fall-back position. What that might be, nobody is saying.

If efforts at reducing deficit spending seem to fall far short of the mark, there may be growing sentiment in Congress for a plain old-fashioned tax increase. The plan that seems to be gaining popularity is a reverse surtax. Under that proposal, companies would pay a tax on the value of the preferences they use to reduce their overall tax bite.

Congress' Joint Committee on Taxation is studying a bill, proposed by Sen. John Chafee (R-R.I.) and Rep. Fortney Stark (D-Calif.) that would levy a 15 percent tax on such preferences. It says this version of tax "reform" could raise $50 billion next year. But three major tax bills in four years have made business gun-shy of any tax measure.

—Peter A. Holmes

NATION'S BUSINESS

BEST

BUSINESS ADVERTISING 1984

The Winners–and Why They Racked Up the Votes

"Capture my interest, and you're halfway to capturing my wallet."

TWO POWERFUL ADS centering on smashups captured the top spots in the second annual Best Business Advertising competition sponsored by NATION'S BUSINESS.

Merrill Lynch's graphic depiction of advantages for investors in the American Telephone & Telegraph Company breakup drew the most votes in the print category. Apple Computer's "1984" ad—which was shown nationally only once, during the 1984 Super Bowl game—took first place in the broadcast category. (It ran locally in a number of markets before the Super Bowl.)

The competition recognizes effective business-to-business advertising for the year 1984. On the ballot in the February issue were 12 print and 8 broadcast ads. They were nominated by creative directors at 16 top U.S. advertising agencies. No more than one nomination could be for an advertisement created by a creative director's own agency.

Final judges in the competition were the readers of NATION'S BUSINESS. Readers are the targets of the advertising, and their opinions should count for the most. As one voter said, "Capture my interest, and you're halfway to capturing my wallet."

Second-place winner in the print category was AT&T Information Systems and its agency Ogilvy and Mather, for its lemon telephone. Third place went to General Motors Electromotive Division and the Martin Agency, for an ad featuring a locomotive on its back.

In broadcast, second place went to International Business Machines Corporation's PC Division and Lord, Geller, Federico, Einstein, Inc., for an ad featuring the now-famous IBM version of the Little Tramp as a roller-skating entrepreneur. Third-place winner was AT&T Communications, for an ad featuring spokesman Cliff Robertson.

Readers were invited to comment on their ballots, and those comments suggest that the winning ads did what their creators wanted them to do. Readers liked advertisements that they considered "funny," "eye-catching" or "simple."

One purpose of the Best Business Advertising competition is to highlight the cooperation between a company commissioning advertising and the agency it chooses to create its ads.

That cooperation was best summed up by Lee Clow, president and creative director of Chiat/Day, Inc., the agency that created "1984" for Apple Computer's Macintosh: "Advertising like this is not done without a client who has vision and courage to push an agency to do work like this, and then pay for it and allow you to run it. It wouldn't have been done without Apple Computer and the kind of energy and entrepreneurial spirit that is that company."

The ad Clow's team created played off George Orwell's novel, showing a huge audience of people in gray fatigues being harangued by a Big Brother figure on an enormous television screen. Into the midst of the audience runs a young woman in bright white and orange with a hammer. She throws the hammer at the screen, which explodes, and the announcer says, "On January 24th, Apple Computers will introduce Macintosh. And you'll see why 1984 won't be like '1984.' "

READERS CALLED the ad "revolutionary, memorably risky," "the most effective, intriguing and timely ad in American history," "the single most dramatic, riveting broadcast ad of 1984," "extremely courageous advertising that demonstrates company attitudes," "powerful stuff." One reader said the ad was "better than the Super Bowl." That was the effect intended by

FIRST PLACE

Advertiser:
Merrill Lynch

Agency:
Wunderman, Ricotta & Kline, Inc.

Ken Musto's team turned AT&T's breakup to Merrill Lynch's account.

PHOTO: WAYNE SORCE

SECOND PLACE

Advertiser:
AT&T Information Systems

Agency:
Ogilvy & Mather

THIRD PLACE

Advertiser:
General Motors Electromotive

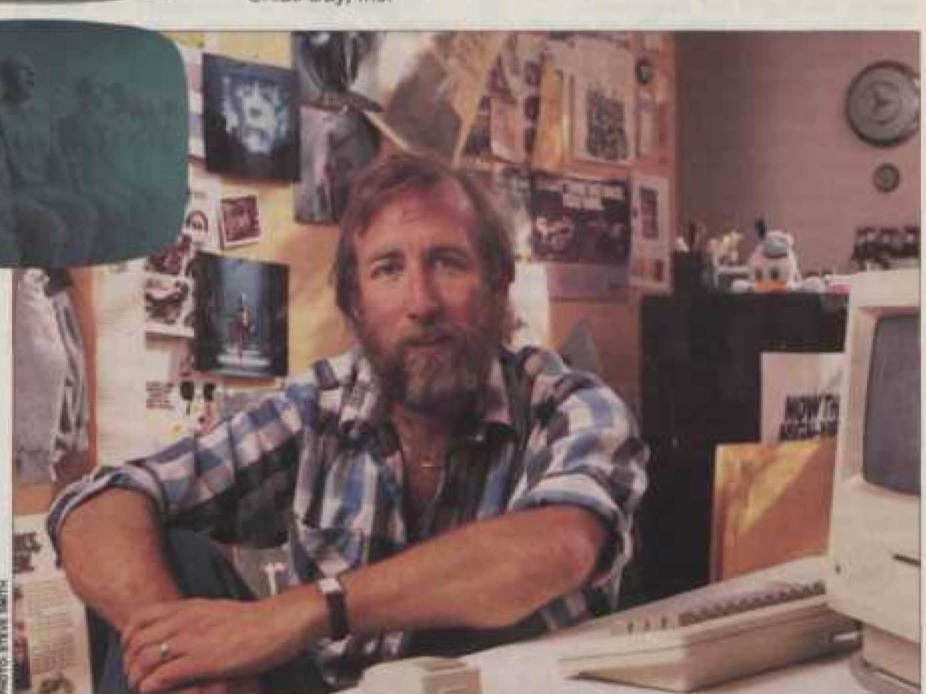
Agency:
The Martin Agency

FIRST PLACE

Advertiser:
Apple Computer

Agency:
Chiat/Day, Inc.

ANNOUNCER: On January 24th, Apple Computers will introduce Macintosh. And you'll see why 1984 won't be like "1984."



Chiat/Day's Lee Clow credits Apple Computer's innovative attitude as a company for creating the right atmosphere to make its famous "1984" Macintosh ad possible.

SECOND PLACE

Advertiser:
IBM

Agency:
Lord, Geller, Federico, Einstein, Inc.

ANNOUNCER: In this rapidly changing world, even the brightest and best manager in the company may need more than a loyal staff to run a smooth operation . . . For rapid improvement, a manager could use a tool for modern times, the IBM Personal Computer . . . It can help a manager excel and become a big wheel in the company. The IBM Personal Computer.

THIRD PLACE

Advertiser:
AT&T Communications

Agency:
N.W. Ayer, Inc.

CLIFF ROBERTSON: A lot of long distance companies would like you to think they're just like AT&T, but take a closer look and see how different they really are . . . Only one long distance company gives you full service. Only AT&T. Sometimes there's just no substitute for the real thing. AT&T. The more you hear the better we sound.

Apple and Chiat/Day. "We were wanting to make a very powerful statement," says Renée Rodrigue, public relations manager for Macintosh.

Apple was getting ready to unveil the Macintosh, and the company hoped to grab the attention of a lot of people at once, without telling them what the product would be. The company wanted to create an event.

Apple believed, says Clow, that Macintosh was a major milestone in computer techonology, "an opening up of this technology to millions of people who until then had found it intimidating or too complex." The agency's writer on the project, Steve Hayden, coined the phrase "the democratization of technology," as the concept to be illustrated, though the phrase was not used in the ad. The ad had to convey the sense of what was special, that "we think we're going to change the world," says Clow.

Chiat/Day first showed the ad at an Apple sales meeting in Hawaii, as a part of introducing the product to the sales force. "The response was so incredible," says Clow, "that we ended up showing it four or five times. Every time it started, everyone stood on their chairs and started cheering, and pretty soon they knew when the girl was going to throw the hammer, and they knew when it was going to explode, and they cheered every time those things happened. And it really pumped up the sales force for the introduction of the product."

The introduction itself was successful: Hundreds of thousands of people lined up at Apple dealers to see the Macintosh on the day it was introduced. The ad made publicity for itself. TV news shows ran clips from the ad, magazines and newspapers reprinted still shots from it.

IF APPLE CREATED an event, Merrill Lynch and the ad agency, Wunderman, Ricotta & Kline, Inc., took advantage of a major business upheaval, the breakup of AT&T.

"There was so much apprehension about the breakup at the time," says Ken Musto, group creative director with Wunderman, "that what we were trying to do was take what was perceived as a negative and make it a positive."

His agency's solution was a plaster-of-paris model of the familiar AT&T letters broken up by a judge's gavel. "It gives the whole story pictorially," said one reader. "You see it, you understand it," said another.

The advertisement was originally created as a 60-second television commercial, says Musto. Almost simultaneously, the agency was putting it together as a print ad and placing it in national media.

Wunderman, a subsidiary of Young & Rubicam, specializes in direct marketing. Its mark is in the winning ad: a coupon in the lower right-hand corner that invites readers to find out from Merrill Lynch why the AT&T breakup could be their lucky break.

The third-place print ad, done for General Motors Electromotive by the Martin Agency, of Richmond, shows the importance of cooperation between agency and company.

Railroading was coming out of the deepest recession in its history, and those who were trying to sell to the industry had a tough job. GM Electromotive decided to show railroads that buying new equipment was going to save them money.

"Essentially, that was our pitch," says Nancy Calvert, the company's public relations and advertising director. "Don't keep running until the wheels fall off; let's get some new."

> "A client has to have vision and courage to push an agency to do work like this and then allow you to run it."

The agency picked up on a theme presented by its client, says David Martin, chairman.

"There was an oversupply of locomotives because the economy was down and because many railroads had more locomotives than they were really using, and how do you sell locomotives in this kind of environment? They wanted to dramatize the fact that money was being lost waiting for your old locomotive to die a natural death."

In a reversal of roles, the writer—Mike Hughes, executive vice president and creative director of the agency—came up with the image of the dead train, says Hal Tench, a vice president who is creative supervisor and art director.

Tench says the client's goal was more than the message itself: "They wanted something completely different from anything they had done before or from anything else that was being published in the rail industry."

That led to the creative team's decision to put the emphasis on the visuals, says Tench, "to make them really arresting, provocative images you really couldn't ignore." It was only then, he says, that the team turned to the content.

It was Tench who came up with the copy line, which, he says, is not unusual for his team. "When you try to solve a problem, there's less emphasis on who's the writer and who's the art director. I frequently write the headlines, and he frequently comes up with the visuals."

There is, in fact, no easy rule about the creative process in creating advertising. All the winners were inclined to say that something unusual had happened.

IBM's Little Tramp/Charlie Chaplin character, who not only took second place in broadcast this year, but also won first place in the print category in last year's competition, was a surprise to its creators, says Robert Wells, senior vice president and director of client services for Lord, Geller, Federico, Einstein, Inc.

"It was a creative fellow and an art director sitting around in a room," says Wells, "and the original idea was to come up with a mime. But the art director couldn't draw a mime. He could draw a Charlie Chaplin character, though. It was kind of a fluke."

TENCH BELIEVES there is a real opening for creativity in business-to-business advertising. "For some reason," he says, "trade accounts have been either with small agencies or regional agencies, or the clients have done a lot of it themselves."

As a result, business-to-business advertising has been less sophisticated than it could have been, he says, and it offers an opening to those clients and agencies that want to be fresh and different.

"There's a real opportunity for ad managers who know the particular pocket of trade advertising they're in is pretty weak and poor to blow their competition away by getting a fairly strong and creative agency," Tench says.

It is advice seconded by Lee Clow, in talking about his "1984" ad for Apple.

The clients have to want to be original: "They first have to look at themselves before they look for an advertising agency that can do it for them. Because they have to want to do it and have the courage to do it before they can achieve a piece of communication like this." NB

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A Better Balance In Bankruptcy Law

It's no longer so easy for debtors to escape from their obligations. But creditors still must be wary.

By Mary-Margaret Wantuck

Attorney Lawrence Young says bankruptcy courts are too busy to look carefully at consumer cases.

MEET CHARLIE, a computer executive making $75,000 a year in 1979. He owned a beautifully furnished $175,000 country home with a $150,000 mortgage and commuted daily into New York City. He and his wife, Sylvia, enjoyed Broadway shows and exclusive Manhattan restaurants.

Charlie loved credit and lived on it—a stockpile of charge cards, a credit union revolving loan and overdraft checking. In early 1980 he reached his credit limit and had to start paying cash for entertainment. But with so much of his monthly income committed to debt service, there was just not that much cash left over to play with, and that annoyed Charlie and Sylvia.

Enter the Bankruptcy Reform Act of 1978, which went into effect in October, 1979.

It was an answer to the couple's prayer. They declared bankruptcy under Chapter 7, which erased all their debts. They were able to keep their house and continue to enjoy all of Charlie's $75,000 salary. They resumed their lives without any obligation to repay any of their creditors.

Charlie and Sylvia are not a particularly extreme example of the new kind of debtor encouraged by the looseness of the 1978 law. During the law's first full year of operation, between October, 1979, and October, 1980, U.S. bankruptcy cases rose 59 percent. The next year personal bankruptcies climbed another 43 percent, to 515,355.

Sears, Roebuck & Company, for example, found that its bankruptcy losses jumped more than 120 percent from 1979 to 1980.

Lenders discovered there were many Charlies and Sylvias—people who were current on their required monthly payments, had little or no previous history of delinquency and may have even had additional credit available at the time their creditors received the bankruptcy notice—but who decided to cash in on the bonanza, get rid of all their unsecured debts and keep their real estate and personal property.

A study conducted by Purdue University's Credit Research Center in 1981 found that 4 out of 10 people who filed for Chapter 7 bankruptcy relief could have paid 50 percent or more of their nonmortgage obligations over the following five years; 29 percent could have repaid all of them.

Montgomery Ward discovered that nearly 13 percent of the accounts it was writing off as losses due to bankruptcy were up-to-date at the time the bankruptcy notice was received. And while Federated Department Stores experienced consumer bankruptcy losses of only $2.3 million in 1979, the figure nearly doubled to $4.6 million in 1980 and reached $5.3 million in 1981.

TRYING TO STEM the tide of losses after the 1978 law went into effect, lenders like the credit union at the National Aeronautics and Space Administration altered traditional lending practices.

The NASA Federal Credit Union raised its interest rates. Borrowers were encouraged to choose its home equity lending plan over the more generally used open-ended loans because "real estate collateral offered greater protection to the credit union should things go wrong," says the organization's president, Donald Beall. (The home equity loan program, which carries a preferred rate, still exists. Because of the greater degree of risk, the credit union continues to charge higher rates for unsecured loans.)

Creditor uproar over bankruptcy losses finally hit home on Capitol Hill. Last June, Congress passed the Bankruptcy Amendments Act of 1984. Among many changes are tighter consumer provisions, which took effect in October. "The law has been improved to everyone's benefit—from the debtor who needs relief to the creditor who was being importuned," Beall says.

Most lenders call the new law better balanced between creditors and debtors. "What it represents is a livable compromise," says Laurence P. King, who was a member of a group at New York University that studied bankruptcy law problems. "The old law was a farce."

Bankruptcy judges can now consider a debtor's current income and expenditures in determining whether his financial situation dictates a Chapter 7 filing or a plan for debt repayment under Chapter 13. Under the old law, only assets and liabilities could be weighed.

Chapter 13 filings have also been modified. An unsecured creditor can object to a Chapter 13 repayment plan

that does not include repayment of the entire debt and use all of the debtor's projected disposable income (beyond the basic necessities) over a three-year period for repayment. Before, a nominal payback was acceptable as long as the debtor's plan showed an effort to pay back something to the creditors.

Consumers may no longer "load up" just before declaring bankruptcy. Any debts of $500 or more for "luxury goods and services," owed to a single creditor and incurred within 40 days of filing, must be paid. So must cash advances of more than $1,000 that are extended under an open-ended credit plan obtained by the debtor within 20 days before filing.

Federal exemptions have also undergone a facelift. In a Chapter 7 bankruptcy, a debtor's personal assets are converted to cash to reimburse creditors as much as possible. However, before a liquidation occurs, the debtor can exempt specified personal items.

Under the law, a debtor can no longer exempt $200 of value on each item of household goods and clothes. There is now a flat $4,000 maximum amount. In addition, a debtor can exempt only $3,750 of equity in real property used as a residence plus $400 in value of other property. The old amount was $7,500 of equity plus $400 in other property.

An added bonus for creditors is that now couples can take either a federal or state exemption—not both, as was permitted before. Thirty-five states do not allow federal exemptions. What they have done instead is raise their exemption levels—which, however, are still lower than their federal counterparts.

Lenders like Jimmie Bearden, president of the Aero Engineering Development Center Federal Credit Union in Memphis, are especially happy about more restrictive collateral provisions.

"Debtors can't hang onto collateral like a car for months now, running it into the ground and having its value depreciate measurably as each day goes by," she says. Debtors have 30 days from the time of the bankruptcy petition to file a statement of intent as to whether they will redeem the collateral, voluntarily surrender the collateral, claim the property as exempt or reaffirm the underlying debt. They have another 45 days in which they can change that decision.

If a debtor elects to reaffirm his debt, no court approval is required.

Bankruptcy judges now have the authority to dismiss a Chapter 7 bankruptcy petition if the judge determines that granting the request would constitute "substantial abuse" of the bankruptcy code.

Buffalo's M&T Bank cut severe bankruptcy losses by creating a special inquiry team and "fighting tooth and nail," says Vice President Michael Noah.

Challenging debtor fraud in a bankruptcy court now is much easier for creditors. The only way a debtor's attorney's fees can be exacted from the creditor is if it is substantially proven that the creditor brought suit solely to harass the debtor, knowing that no fraud was involved.

Lawyers' responsibilities have increased. A debtor's attorney must now inform his client of relief other than Chapter 7 that is available for resolving his financial problems.

IN THE PAST, "in courts where not too many Chapter 13s were filed, the debtor may not have known there was another recourse," says Lawrence Young, a Houston attorney with expertise in the consumer bankruptcy area. "Much of the preparatory work was handled by paralegals; it was a fill-out-the-forms-and-file atmosphere. Now, instead of running an assembly line in court, lawyers are back in the business of lawyering again."

Most creditors believe that it is still too early to get a fair reading on how the law is working. Norman Magnuson, a Sears spokesman, says that "initially, the company thought the new law would dramatically cut down the number of bankruptcies. Unfortunately, we still haven't seen a tremendous change. But since the law has only been in effect for six months, we're going to stand back and wait a while before assessing the situation."

Creditors say the law still has weaknesses. Too much potential for abuse exists, according to Alexander Cole, senior vice president of credit administration for Industrial Valley National Bank & Trust Company in Philadelphia.

"As long as consumers have the right to retain some equity in their homes and on other assets under federal exemptions, notwithstanding state overrides," he notes, "they may find ways of abusing that right."

Determining whether there is substantial abuse in a Chapter 7 filing may take so much time that a busy judge may leave review of a debtor's financial status to a court trustee. The trustee would then have a major say in whether a case should remain Chapter 7 or be switched to Chapter 13.

"Many bankruptcy courts are very, very busy," Young says. "In the southern district of Texas, for example, there are 17,000 bankruptcy cases pending, and only two judges; the third position is vacant. But even three judges are not going to make much difference."

With Chapter 11 business reorganizations like that of Continental Airlines taking up a great deal of the courts' time, Young says, consumer cases are going to get short shrift. "The issues in an individual case are just not that weighty; the effect on society overall is negligible," he says.

And the definition of "substantial abuse" is left to the judge in each case.

Bankruptcy experts say that since the Supreme Court has yet to issue rules governing bankruptcy judges'

scope of review for substantial abuse under Chapter 7, the judges may well balk at dismissing cases without persuasive evidence.

Ambiguous as it is, however, the substantial abuse provision seems to be having a preventive effect.

"We're finding a lot more Chapter 13 filings than Chapter 7s right now in western New York State," says Michael Noah, vice president and regional manager of branch banking at M&T Bank in Buffalo. "I think that attorneys are fearful that judges may be throwing out a lot of Chapter 7 cases, so they're advising their clients to go the Chapter 13 route."

M&T Bank, a $2 billion institution with more than $450 million in consumer loans, wasted no time in tackling abusers of the 1978 law right from the start. Bankruptcy losses were piling up. The bank had been left reeling by a local economy that was traumatized by a depressed steel industry, the main source of livelihood for many of its customers. New rules permitted attorneys to advertise, and some ads in Buffalo publicized how easy it was to declare bankruptcy.

"We had to stop the bleeding," Noah says. "One year, we charged off just under $2.5 million in bankruptcy losses. So we developed a system of reviewing every bankruptcy petition before it came before a court. Our three-person bankruptcy team knew cases inside and out. They knew customers' ability to pay; if they were hiding income; whether they were just taking advantage of the bankruptcy code to avoid debt payment. Then we'd go after them. We won a lot of cases and lost just as many. If we felt that our losing was unjustified, we went to a higher court."

The program lasted two years, ending in 1982. It was expensive but, Noah says, worthwhile. "We figure that we generated $750,000 in Chapter 13 filings—cases that would probably have been thrown out of court otherwise." Bankruptcy write-offs are now below $250,000 annually. The bank has considerably tightened its credit policies.

Many creditors argue that bankruptcy write-offs would decrease dramatically if the new law ordered bankruptcy courts to take a debtor's future earnings into account.

In the specialized publication *Credit*

Why—and How—To Avoid Bankruptcy

Thinking of filing for personal bankruptcy? Think again. There are less drastic ways to regain your financial footing, suggests the American Financial Services Association, a consumer creditor group.

Start with adjusting your budget. All this may entail is cutting back on frills. Talking to relatives can be useful. They are usually good sounding boards and may offer solid advice, particularly if they have suffered past financial reverses. Notify your creditors immediately of problems in meeting payments. Generally, they will do all they can to help.

File with credit bureaus an explanation of your credit or legal difficulties and provide any missing information on your credit activity. You may wish to consolidate your debts so that you pay a smaller amount per month for a longer time.

But if you think your situation has deteriorated past your ability to deal with it, a consumer credit counseling service may be the right way to go.

Robert Gibson, president of the National Foundation for Consumer Credit, whose members are credit counselors, explains how they work.

"A financially overworked individual will be referred to one of our members by a minister or union shop steward, even by creditors in some cases. In the Pacific Northwest, Sears, Roebuck will send—along with its notice of delinquency to a customer who is making partial payments or none at all—a letter indicating that there may be a problem and recommending that the customer talk with a counselor at no cost."

PHOTO: T. MICHAEL KEZA

Too deep in debt? Do this to credit cards, suggests Robert Gibson.

The interviews, says Gibson, normally last from one to three hours and delve into a family's spending patterns, its total income and its total obligations. Then the counselor assesses whether adjustments can be made—getting creditors to accept reduced payments, for example, or eliminating interest payments or late charges. If all goes well, a payment program is worked out.

Counseling services can charge if state law permits. If they do, the fee is nominal. Those nonprofit counseling services that do not charge are supported by a bevy of charitable organizations like United Way, and even by credit grantors.

The Consumer Credit Counseling Service of Greater Denver, Inc., enjoys the support of 7,384 creditor members, many of them small businesses. According to Executive Director Larry Smith, the general contribution pattern is for creditors to give Consumer Credit 7 percent of whatever amount of debt repayment the organization has been able to secure for them.

Since its inception in 1967, Consumer Credit has helped 27,000 clients, prepared 15,414 payment plans and successfully led 24 percent of its clientele to repaying all debts. For creditors, this has meant recouping debt payments totaling $36.5 million.

There are six counselors on staff, and each averages 350 cases a year. Their job is to give debtors counseling and budget advice, institute debt payment plans, distribute monthly payments to creditors and help in reestablishing credit—all for free.

Graduates do not have to worry about carrying the stigma of "credit leper" for 10 years, as they would if they had filed for bankruptcy.

Says the National Foundation's Gibson: "I'm concerned about those young people, three to five years out of college with good jobs, who find themselves overextended, and who are told that all they have to do is file a petition for bankruptcy and they're in the clear. It may sound great at first, but three years down the road, when they want to buy a house or apply for a credit card or get a bank loan, they find that they're in trouble. Nobody wants to deal with them."

—Mary-Margaret Wantuck

World, Harry Wolpoff and Ronald Canter, lawyers specializing in consumer credit law, have described what can happen when future income is not taken into account.

A doctor is serving a one-year residency at a hospital where he receives a weekly salary of $150 plus living accommodations. Shortly, he will fill a $40,000 teaching post at a medical school. His debts total $15,000. Two months before starting his new job, he files for Chapter 7 bankruptcy. The income statement disclosed to the court reflects only his present $150 salary. Disposable income left after paying necessary expenses is minimal. The authors say his filing probably would not be challenged.

Particularly unfortunate for creditors is that even if they learn a debtor has prospects that would make him eligible for Chapter 13, they are barred by law from informing the court.

Reaffirmation agreements pose another problem. The new law in no way prohibits the debtor from changing his mind regarding his stated intentions. He is free to rescind the agreement within the 45-day grace period.

Credit counselors are decrying the law's omission of a requirement that all petitioners go through counseling.

"There are people who go through the bankruptcy process, are adjudicated as debtors and released by the courts without having learned anything," says Robert E. Gibson, president of the National Foundation for Consumer Credit, whose members are credit counseling services. "They are subject to continuing money mismanagement and financial catastrophes."

Gibson says the bankruptcy process should be a learning experience for debtors. "They should understand how they got into the situation, what they can do in the future through sound financial management to prevent that from happening again," he stresses.

But creditors say most of the changes in bankruptcy laws are good, and they do not expect to see any more revisions soon. After struggling for years over changing the law, "the last thing Congress wants to see on its agenda is bankruptcy," Young says. NB

To order reprints of this article, see page 81.

Keeping a Small Business Afloat

Consultant Emery Toncré (standing) advises small business clients on how to keep in the black.

Current estimates are that 9 out of 10 new small businesses will go under in their first year. Some will close their doors quietly. Others will make more of a splash, by declaring bankruptcy.

Bankruptcy has become the cancer of the business community, says Emery Toncré, president of Emery Toncré & Associates, a management and tax consulting firm, and of Opp International, a nationwide company that assists small business.

Small businesses do get a number of warning signs, according to Toncré. Among them:

- Insufficient working capital. When cash is always short, when owners find themselves doubling up on invoices and holding back bills, trouble is brewing. Owners should establish a cash reserve and update it regularly so that in an emergency cash levels are not drained.
- Sudden drop in bookings. This can be especially dangerous since the drop will not be reflected in immediate receipts but will only become apparent 60 to 90 days later, when there is no cash to pay expenses. An owner can be further deceived if bookings pick up before the cash flow falls off. When a drop occurs, cash reserves should be tapped and operations tightened up.
- Creeping expenditures. Businesses are particularly lax about capping some of their expenses—travel, telephone bills, superfluous personnel—when times are good. Owners should be prudent.
- A sudden need for an additional loan. Having to secure short-term—30 or 60 day—bridge financing to shore up sagging working capital is a harbinger of doom.
- Questioning by employes. Often, employes are the first to recognize that the business' operations are out of kilter. Owners' ears should prick up when employes make their doubts known.
- Withholding invoices. When owners start making excuses to their creditors, this is a dead giveaway.
- Misusing the Internal Revenue Service. Some small firms look to the IRS for credit extensions, because it is slow to respond to delinquencies. When an owner is finally caught, he ends up paying not only the amount owed originally but a sizable interest penalty as well—sometimes more than 50 percent of the delinquent tax liability.
- Accepting work below marginal cost. Business is static. Employes and machines are idle. Instead of doing some belt tightening, the owner takes below-cost work from any customer without even checking credit ratings. When the job is finished and those customers do not pay, the firm is in a deeper hole.

Bankruptcy is most likely during the first 18 months of a firm's life, according to Toncré. The uninitiated entrepreneur takes his working capital to the very limits without thinking about what he is jumping into, or the complexity of the business' nature, and he collapses.

The second most dangerous period occurs when a firm has been in existence for about six years. The owner is lulled into complacency. What he has done has worked successfully so far, so why should he change? Meanwhile, the market has taken off in several different directions.

If a business owner recognizes that his operation is on shaky ground, he may need a specialist who can resolve his predicament, says Toncré. The professional will put a halt to expenditures to assess what is wrong. Next comes a program of cash conservation—selling some of the business' inventory, equipment, even physical space—whatever is necessary to re-energize the firm.

—Mary-Margaret Wantuck

A Travel Market Built On Quality

Today's vacationer wants experiences, not sightseeing.

By Bob Gatty

WHAT DO YOU do when you teach ski racing and your wife is a ski instructor and you go through a winter with virtually no snow and no paying students?

That was the dilemma facing Bob and Cindy Maynard of Waterbury Center, Vt., a few years ago. "We wanted to stay in Vermont," Bob says. "We love it here. But we had to find something that was less dependent on the weather."

So the Maynards decided to capitalize on the growing desire of many Americans for active vacations and on the trend toward physical fitness. They opened Vermont Country Cyclers, offering bicycle tours through Vermont and along the coast of Maine, complete with stays at fine New England country inns, gourmet meals and plenty of physical activity.

Vermont Country Cyclers provided tours for 110 customers during its first season, six years ago. Last year the figure was over 2,700. Maynard says 70 percent of his business comes from repeat customers, mostly young to middle-aged professionals "who are into physical fitness and want to do something more than just lie on the beach."

Today, Vermont Country Cyclers, like many other companies—from those that run white water rafting excursions to ski resorts—is taking advantage of the growing affluence of younger travelers.

"A few years ago, I don't think we would have had many of our customers," says Bob Maynard. "Almost all the people who tour with us are experienced travelers. A good many have been to Europe, and lots of them go on ski vacations."

Many experts believe that the young, urban professionals are an emerging force in the travel market.

"Yuppies are interested in what's trendy and what's showy," says Patricia Duricka, a spokesperson for the Travel Industry Association of America. "They are more interested in trekking in Nepal than in going to New Orleans, for example."

Duricka notes that this group "is just coming into its own in terms of money" and is relatively free of family responsibilities. "Their interest in travel is quite high."

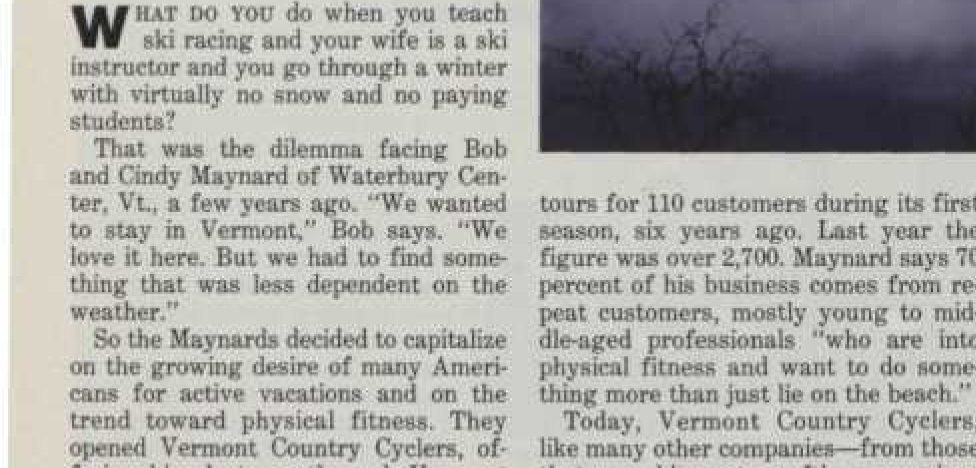
Lawrence P. Horwitz, president of Cartan Tours, of Rolling Meadows, Ill., says the trend is "toward more luxury, more adventurous travel. People want experiences, not just sightseeing."

Yuppies, Horwitz says, want to make the most of their vacation time because they have busy careers. They are no strangers to travel, he adds, having traveled with parents or alone as students.

"This is not a big market yet, but it is starting to get larger and larger," he observes. "What you see now is people with the resources and the inclination who are used to traveling. They want to experience more and be participants in local culture."

Cartan Tours, which, Horwitz says,

PHOTO: CLIPPER CRUISE LINES



Deluxe vacations appeal to those who want to make the most of their vacation time. One cruise stops at 22 ports in 29 days, from Fort Lauderdale to Boston.

PHOTO: LANNY JOHNSON

Younger travelers are entering the market, and they are interested in the exotic and unusual. Some of them would rather go trekking in Nepal than closer by.

Vermont Country Cyclers' tours through Vermont and along the coast of Maine capitalize on the growing desire of Americans for active vacations.

PHOTO: VERMONT COUNTRY CYCLERS

offers upscale, deluxe vacations, has put together trip packages like one to the China Marathon, a race in which travelers can run if they wish. Another Cartan offering, the Great American Odyssey, is a cruise on what Horwitz calls "an ultra yacht," which stops at 22 ports in 29 days, from Fort Lauderdale, Fla., to Boston.

David K. Hillman, senior vice president at Thomas Cook Travel in New York, says vacation packages, in which travelers pay for accommodations and transportation—often at several locations—in a lump sum, are growing as a major force in the industry.

"People are looking for a good value in their vacations," he explains. "They are gravitating to package deals in vacation areas. Until recent years, package vacations weren't very appealing to our clients." Now, he says, the idea has become more attractive as people come to realize that a "tour" does not mean that you will be traveling with a particular group of people wherever you go. The attraction, Hillman explains, is the "economy" resulting from travel

Continued on page 58

Where the Bargains Are

Joseph Ney, owner of Embassy Visa Service in Washington, specializes in obtaining documentation for travelers heading for destinations abroad. Ney says there are bargains all over the world—if you can discover who is offering them. For example, one firm, Vacation Travel Concepts in New York, offers a week in Rio de Janeiro for about $600 per person, including air fare and hotel.

His company works with thousands of travel agents and tour operators, and Ney offers these travel bargain tips:

- "As long as the dollar keeps going as it is, Europe will be the best bargain. France is the cheapest it has been in 20 years." Ney says he spent Christmas in Europe and stayed in small, one-star hotels. He paid about $17 for a room with a bath in Paris for himself and his family, he says.
- Europe's top buys are, in order, Portugal, Spain, Italy, France, England, Austria and Germany.
- Yugoslavia, Greece and Poland are all "exceptional" travel values.
- South Africa offers good accommodations and reasonable prices once you get there. The rest of Africa is generally not a bargain, with high prices and a choice between only luxury accommodations or very poor ones. The same holds true for India and Pakistan.
- New Zealand, because of exchange rates, is a travel bargain.
- The Philippines is "a good buy and a great place to visit. Good accommodations, low prices and delightful people."
- In general, the Orient is expensive, as are Middle Eastern countries. Egypt "isn't the bargain it once was," although Morocco and Tunisia are still good buys.
- In Central America, Costa Rica is the best travel bargain for Americans because of the exchange rate.
- Some major car rental companies allow you to arrange for car rental in Europe before you leave. If you wait and rent abroad, it costs about double.
- Currency exchange practices are important. In some countries, like France, Spain and Hong Kong, you can get about 3 percent more for traveler's checks than for cash. Be careful about ads for money changers who offer rates better than the banks. They may charge a commission, making the end result less favorable.

How Firms Can Write Tickets

Lower air fares should add impetus to an improved year for the travel industry.

CORPORATE travel departments, as a result of recent deregulation of the travel agents' industry, can now become full-fledged accredited airline ticket agents, obtain commissions on tickets they sell, and sell directly to the public.

But there is one catch. Although regulations now make these commissions possible, airlines are not rushing to pay commissions on corporate ticket sales, and will not unless forced to by competition.

The new opportunities for corporate ticket sales stem from a Civil Aeronautics Board decision, removing the antitrust immunity that previously allowed travel agents to be the exclusive sales agents for the airlines. It resulted in the creation by the airlines, through the Air Transport Association, of the Airline Reporting Corporation, which now processes airline tickets sold by travel agents. ARC was established last January 1.

In approving the new system, the Justice Department insisted that corporate travel departments not be required by organized industry action to sell a minimum percentage of tickets to the public in order to qualify. The old requirement was 80 percent.

"That means that the door would seem to be wide open for the corporate travel department," says Bill Jackman, assistant vice president of the ATA. But, he notes, the airlines have begun to establish their own requirements for accredited agencies, and at least 10 have decided to retain requirements more rigid than those set by ARC.

Retaining the 20 percent limit on self-sales are Alaska Airlines, American, Delta, Eastern, Frontier, Northwest, Ozark, Republic, United and Western.

Delta and Eastern require that agencies be open to the general public 35 hours per week on a regular schedule. Delta insists that an accredited agency be staffed by a full-time manager with experience at an airline or travel agency. Eastern requires that accredited agencies have a full-time manager with at least two years' experience in selling air travel either at an accredited agency location, an airline or a business travel department.

Many airlines also refuse to pay commissions on self-sales. "The carriers are in no hurry, obviously, to get into a situation where they will be competing, with commissions, for a company's business," notes one industry analyst.

There are other ARC requirements, which most corporate travel departments should be able to meet.

The corporate travel department must have at least one full-time manager who:

- Exercises daily supervision of the location.
- Demonstrates a working knowledge of the ARC travel agents' handbook.
- Has at least two years' full-time experience selling travel services to the public.

In addition, that person or another full-time employe must have had at least one year's experience in airline ticketing within the past three years.

The place of business must engage primarily in sale of air travel and be freely accessible to the public. However, for in-plant offices, those whose primary purpose is to issue tickets to company employes, the person meeting the ticketing experience requirement can be an employe of either the company involved or of a travel agency that may operate the corporate travel office. In fact, if the in-plant location is a branch of an ARC-listed agent, it need not meet the personnel requirements.

"Now that these provisions are in place," says Jackman, "corporate travel departments can easily become ARC-listed agents. It is then up to them to convince the airlines that they ought to be paid commissions." NB

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Continued from page 55

agents' volume deals with providers of accommodations and transportation.

The most popular destinations for package-deal vacations today, Hillman says, are the Caribbean, Mexico and Hawaii. "In addition, there is a significant amount of travel to the United Kingdom because of the strength of the dollar." In fact, many Americans are choosing travel destinations abroad, particularly in Europe, because of the extremely favorable exchange rates.

New super discount air fares were announced in January by American Airlines and quickly matched by other major carriers, with reductions of 70 percent in regular coach fares for those booking at least 30 days in advance. They have caused airline bookings to soar.

Though the bargain fares mean in many cases that airlines are dropping discounts with shorter booking requirements, which makes bargains harder to come by for business travelers, airline executives say the vacation traveler is getting a great deal.

Thus, the new air fares should add an impetus to what travel industry officials hope will be an improved year in 1985. And they are hoping that many American vacationers will decide to visit U.S. destinations despite the strong dollar and favorable exchange rates abroad.

Last year was somewhat disappointing for travel industry officials, who were hoping that Americans would release a pent-up urge to travel that had been held back because of the recession and poor economic climate of the early 1980s.

Douglas C. Frechtling, director of the Travel Industry Data Center in Washington, says travel growth last year was modest and that industry receipts grew somewhat slower than the gross national product.

Frechtling blames this disappointing performance on most Americans' first buying such necessities as automobiles, appliances and furniture—purchases that had been put off because of the uncertain economy—before spending on travel.

"People said, 'My gosh, let's buy those things we held off on,'" Frechtling explains. He notes that consumers spent an additional $100 billion last year on durables—"money that would have financed a travel boom in more normal recoveries. I hope that changes in 1985."

"I've traveled across this nation," says Donna F. Tuttle, an under secretary of commerce for travel and tourism. "There are exciting places to visit at very reasonable prices. We have to wake up and promote the United States."

As head of the U.S. Travel and Tourism Administration, Tuttle has the job of promoting the United States as a destination for travelers from abroad. "We make money here," Tuttle says, noting that in 1983 foreign travelers generated $854 million in federal taxes plus another $802 million for state and local governments. The 1985 USTTA budget is $12 million.

Working with the Travel Industry Association of America, Tuttle's office commissioned a detailed survey of markets abroad by the Gallup organization and developed an advertising theme—"America. Catch the Spirit"—for promotions abroad. The ad campaign is to

be used by the nation's tourism companies—the hotels, air carriers, resorts—to promote the United States and their specific offerings.

Tuttle says the Gallup survey showed that this country is the most popular vacation destination for British, West German and French citizens planning to fly outside Europe this year. Respondents in all three nations rated the United States' scenic beauty as its most attractive feature, followed by the chance to meet the American people and to experience a different lifestyle.

THE GRAND CANYON and Rocky Mountains were the places the British most wanted to see, along with California, Florida and New York. Germans showed more interest in U.S. beach vacations, and most wanted to visit Hawaii, New York and Florida. The French were interested in U.S. theaters and nightlife, and wanted most to visit California, Florida, New Orleans and New York.

Tuttle says the "Catch the Spirit" theme will be used initially in a $1.25 million advertising campaign to be launched late this summer in Germany. She says U.S. companies and destinations will be joining the USTTA in cooperative ventures and will use the theme in their own advertising and promotional efforts.

"I strongly believe that the federal government has a role to play in the promotion of international tourism to the United States," Tuttle says, noting that international travel is a significant contributor to the U.S. balance of trade—at a time when the nation is experiencing record trade deficits.

But Tuttle has a problem. The Reagan administration's budget for fiscal 1986 would close down the USTTA just as it is about to embark on this new ad campaign.

TIA President William D. Toohey is hoping the industry can convince Congress to fund the agency at least at current levels. "This is one government program that produces," he says. "It generates real tax revenue. Tourists from abroad spend money. They pay sales and excise taxes. They create the need for jobs." In fact, Toohey says, one new job is created by every 52 foreign visitors.

William Edwards, president of Hilton Hotels, says the "extinction of the USTTA cannot be allowed to happen." He and other industry officials are working to convince Congress to fund the agency in 1986.

"The travel industry must unite and flex its political muscle because that is

Donna Tuttle, whose job at the U.S. Travel and Tourism Administration is to get foreigners to visit here, has a "Catch the Spirit" theme for promotions abroad.

the language most clearly understood in official Washington," says Sen. Daniel K. Inouye (D-Hawaii), chairman of the Senate tourism caucus.

The Travel Industry Data Center says that in 1983, the last year for which final figures are available, total travel spending in the United States was $210 billion, with $11.4 billion coming from foreign visitors. The second largest employer nationwide, the industry directly and indirectly employs more than 6.8 million persons.

A major promotion for the second consecutive year will be National Tourism Week, May 19-26, proclaimed by President Reagan under a resolution approved by Congress. The theme is "Tourism Works for America," and tourist industry companies are using it to inform the nation about their industry's importance to the economy.

If the USTTA ad campaign generates increased tourism from Germany, and later from other European nations, chances are that many of those visitors will be looking for the same kind of experiences as America's Yuppies.

The Gallup survey showed that a substantial European youth market exists for vacations in America. Among those who said they plan to visit the United States this year, a quarter of the British and one third of the Germans and French are under 30.

But there are concerns today about a changing American lifestyle. While the Yuppies look for adventure when they travel, they demand quality. And they may not travel as often as other social groups in previous years.

"The Yuppie is well-heeled, active, highly educated," says Frechtling. "Education and travel go hand in hand. But he is also gadget-oriented. From what I'm seeing, a lot of these Yuppies won't be free spenders like their counterparts in the previous generation."

Frechtling says short trips declined last year, suggesting that "people were finding other things to do." He notes that sales of videocassette recorders hit record levels, perhaps taking up some of this leisure time.

"Every new fad or gadget takes time away from existing leisure activities, and there is thus more competition than ever for the consumer's leisure time and spending," notes Harold Vogel, a Merrill Lynch vice president.

Still, 1984 travel industry receipts were up 10.5 percent over 1983, with a 4.5 percent average price increase accounting for part of that rise. Both vacation and business trips increased by 6 percent. Travel-related employment increased 4.4 percent.

INDUSTRY ANALYSTS were somewhat disappointed with these figures, because they resulted in growth that lagged behind the overall economy and were less than expected.

Frechtling says things should improve, however. "The travel business is good, but not as good as it should be in this strong economic recovery," he says. "History suggests 1985 should be a better year than 1984."

Promotion is essential, Frechtling adds. "We've got to position the American vacation destination as an exciting place to go for some and a relaxing place for others. Travel offers a change from the humdrum course of life—a change of pace. And this is the time to travel, if ever it was."

To order reprints of this article, see page 81.

A Lullaby of Wall Street

By Ray Brady

Me worry about the stock market? Listen, I go to bed at night and sleep like a baby—every hour I wake up and cry a little.

Old Wall Street joke

EVEN WITH THE STOCK market roaring ahead for much of this year so far, that joke has had a lot of validity. Perhaps Wall Streeters are not crying as they did last year, when the market was a disaster for nearly every investor, but they are waking up at night quite a bit more than most of them like to admit.

Some of the sleeplessness comes sporadically, as when International Business Machines Corporation said it would be "very difficult" for the company to show an earnings increase in the first quarter; all the technology stocks went tumbling like nine-pins.

But even during the long sessions when the market has been strong—and virtually everything has been going up in price—there has been more nervousness than usual. After a dismal 1984, many investors this year have a different worry. It is simply this: Should I take the profits I have made this year and run with the money? Or am I going to be losing out on even bigger profits that could be made later this year?

Robert Colby tracks the market for the investment firm of Smith, Barney & Company. He is one of the optimists, and he says a Dow Jones Industrial Average of 1325 to 1350 "sounds reasonable for the future, and you might even possibly get another 100 points beyond that."

One way Colby determines how high the market can go is to look at the price-earnings ratio of the Dow itself. The price-earnings ratio—the number of times per-share earnings can be divided into the price of the stock—can be the most meaningful measure of whether a stock is overpriced or not. The same is true of the Dow and the earnings of the 30 stocks that make it up. "Anything below 10 times earnings is cheap," Colby says. "When you get to 15 to 20 times earnings the market is getting pricey." The Dow's ratio has recently been just over 10 times earnings, not dangerously high territory.

RAY BRADY *is the business correspondent for CBS News.*

If you think of the stock market as a kind of hot dog stand, it's a little easier to understand what is meant by terms like "oversold" and "overbought."

Still another measure of the market's strength is how much cash the mutual funds have on hand. Most of the buying in the market comes from big institutions like mutual funds, so if their cash reserves get low, that means money will not be coming into the stock market. If the big players drop out of the game, say some theorists, stock prices are sure to drop.

Currently, though, about 9 percent of mutual funds' assets are in cash. "When the figure gets down to 4 to 6 percent," says Colby, "that might be a signal that the market is about to top out."

RALPH BLOCH, technical analyst at Moseley, Hallgarten, Estabrook & Weeden, in Chicago, often watches a related signal to determine the future course of the market. "The real sign of a top," he argues, "is when the industrial index is leading and the rest of the market is lagging."

That would mean, of course, that only the handful of stocks in the Dow would be going up, but not the others. Just the reverse has been true much of this year, it should be noted, and it is one reason why—even though they worry about when to sell—most investors seem reasonably confident.

Some technical analysts follow really complicated formulas to determine if investors have been too enthusiastic in buying or selling, and the market is about to react by moving violently one way or the other.

Such formula-following can require many hours of poring over charts of a stock's performance. Not only that, but charts of this type have to be interpreted, and opinions may differ on what the chart of a stock—or of the whole market—really shows.

It should be noted that professional investors have always been of two minds about measurements of this sort, many arguing that the supporters—and practitioners—of this kind of analysis are like so many ancient Roman soothsayers, mumbling incantations over chicken entrails and trying to read the future from them. Terms like "oversold" and "overbought," snorts one, "are overdone."

Alan Shaw does not agree. He is the chief market technician at Smith, Barney. To Shaw it is all eminently logical. The stock market, he says, is like a hot dog vendor selling his wares on the street corner. Before lunchtime the vendor sells his hot dogs for 40 cents. But, then, as noon arrives, bringing more customers, he raises the price to 50 cents. More customers, and the price goes up again, to 55 cents.

At some point, the customers have had enough to eat, or the price of hot dogs (or stocks) is too high for them. Buying stops. "That," says Shaw, "is overbought." NB

Marketing in a Gray Area

If you purchase foreign merchandise from discount stores or catalog retailers, chances are you are buying on what is widely called the gray market. That may mean you have gotten a bargain on a quality, name-brand camera every bit as good as the full-price product sold through normal trademark channels.

Importers usually buy trademark rights from overseas firms, along with factory warranties and the right to advertise and sell to selected vendors in this country.

Gray marketers call what they do "parallel importing." Buying through middlemen from foreign factories, they bring in the same products as those who have bought trademark rights. It is common for gray marketers to return your money or replace an item if it is faulty.

So why is there a fuss about gray marketing, a multibillion-dollar phenomenon that has ballooned as the strong dollar has made imports more desirable? Why, though it has won President Reagan's support—at least for now—has it left many in Congress wrestling over its impact on the economy and individual consumers?

Scott Gilbert, the Washington-based general counsel to a group called the Coalition to Preserve the Integrity of American Trademarks, says gray marketing robs trademark owners of their investment. COPIAT's members include Revlon, Inc., Nikon Inc., the Seiko Corporation of America, Waterford Crystal, Inc. and dozens of other American companies that own the right to vend foreign-made wares.

COPIAT calls gray marketers "free riders." "They get a free ride on the significant investment and good will of U.S. trademark owners," Gilbert says. Nikon, Seiko and other firms spend millions promoting their goods "in a very brand-conscious society," says Gilbert. Then, he says, the gray marketer comes along and skims easy profits off this expensive marketing effort.

But K mart spokesman Robert Stevenson says gray marketing benefits the consumer. "The only one who loses out is the foreign manufacturer's distributor who has the goods marked up so high." Trademark owners' real objective, adds Stevenson, "is to stay away from price competition."

In courts across the country, trademark owners are challenging gray marketing practices, but the judicial history so far is unclear. The Treasury Department favors gray marketing. Congress is of many minds. The Commerce Department sees problems with the practice. President Reagan recently ordered a task force to sift through the controversy and produce a uniform recommendation.

"We see it essentially as a free trade issue," says Assistant Treasury Secretary John Walker, adding that his de-

partment would frown on passage of a law against gray marketing that would be "used to create substantial price differences" to the detriment of consumers.

Says President Edward Borda of the Association of General Merchandise Chains: "We challenge those who would abolish parallel imports to demonstrate how consumers or the economy would benefit from higher prices and reduced competition—which would inevitably follow if parallel imports are no longer permitted." AGMC represents over 20,000 retailers, including discounters.

A recent decision by the International Trade Commission focused white-hot attention on the issue. Duracell, Inc., an American company, complained to the ITC that a gray marketer was importing alkaline batteries from Duracell's European subsidiary and selling them below American Duracell's retail price. An estimated 30 million European-made batteries have been sold on the gray market.

Washington trade lawyer James Bierman argued before the ITC that Duracell's trademark property is being damaged, that consumers are getting less than fresh batteries from abroad and that U.S. jobs are being lost. The ITC banned the European batteries.

In January, President Reagan, at the Treasury Department's urging, reversed the ban. The President said he wanted no precedent-setting actions taken until his cabinet council on commerce and trade had a chance to thrash out the gray market issue.

Bierman says the Duracell case is not a clear example of gray marketing, since the parent company is American. But K mart counsel Robert Hebda says the effect of the ITC decision would have been "to outlaw all parallel imports and unjustly enrich foreign multinational corporations that want the United States government to enforce international market divisions to the detriment of the consumer."

AUTOMOBILE gray marketing is booming, and some are complaining that the bargains they got on their Mercedes cars are proving very costly. Rep. Matthew Rinaldo (R-N.J.) has introduced legislation to halt gray market auto imports that do not meet federal safety and emissions standards. Too often, he says, gray market consumers must pay extra to bring their imports up to snuff. Some cars cannot be altered successfully and are seized by the government for noncompliance.

In addition, says Rinaldo, many sellers on the auto gray market are perpetrators of frauds. "This is an area," he says, "where sharp practices thrive, from the mail order or storefront importer who takes a hefty deposit and then vanishes, to the importer who repaints a used car and sells it as new, to the modifier who charges several thousand dollars for a modification job that is done poorly or not at all. Also, the gray market has made the United States a haven for stolen vehicles from abroad."

Rep. James Florio (D-N.J.), chairman of the House Commerce, Transportation and Tourism Subcommittee, plans to take on the whole issue in hearings this summer. Gray marketing is a mixed blessing, he says. "It gives the consumer greater access to products at competitive prices. It also infringes upon property rights of trademark holders, and it raises questions about the safety and environmental standards of products."

With the courts, Congress and executive agencies all in the act, an early or a tidy resolution is unlikely.

—Henry Eason

The Walls Between the States

Barriers to trade may cost $100 billion a year.

By Michele Raymond

NOT LONG AGO, you could not buy wine in any form in New York State grocery stores. Today, though, you can buy wine coolers in grocery stores—but only certain brands.

The New York legislature has decreed that only wine coolers—mixtures of wine and fruit juice—made from 100 percent New York-grown grapes may be sold in grocery stores. Out-of-state wineries claim the new law conflicts with the interstate commerce clause of the U.S. Constitution and with federal antitrust laws.

Such state laws, and the litigation they generate, have long been common, despite the Constitution's prohibition on interference with interstate trade. Although most interstate trade barriers are raised to protect jobs in a particular state, the net effect is to drain more than $100 billion from the American economy every year.

That is the conclusion of two University of Houston economics professors who studied the problem for the university's center for public policy. Over a two-year period, Joel Sailors and Steven Craig surveyed purchasing laws in all 50 states and reviewed other studies.

The liquor industry faces the largest number of state laws and regulations. "Selling wine in the different states is like selling it in 50 foreign countries," says a spokesman for the California Wine Institute, one the the largest state associations.

New York State Liquor Authority Chairman Anthony Gazzara explains the new wine-cooler law: "The local grape growers had an excess supply of product and couldn't sell it. They successfully lobbied the legislature on this law, to protect jobs in this state."

A California winery filed suit and won. New York won a stay until it could appeal, and the wine coolers will stay on grocery shelves.

Attorneys for the state defend the law on the ground that since wine coolers are not federally regulated, the states can regulate their distribution. "We're not shutting them out," Gazzara says. "They can still sell their wine coolers in package stores."

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State governments have also erected trade barriers involving their own purchases of goods and services. Called purchasing preferences, these laws allow in-state providers to charge the state up to 5 percent more (and sometimes as much as 20 percent more, on certain types of goods) than out-of-state competitors.

"As of 1980," Sailors says, "we found that 23 states had some form of these laws."

The insurance industry must contend with thousands of state regulations

PHOTO: CHARLES STEINER—PICTURE GROUP

Anthony Gazzara: New York passed a wine law "to protect jobs in this state."

that increase its cost of doing business. Possibly most severe are the restrictions that many states impose on how insurance companies can invest their reserves. For example, no insurance company can do business in New York if it has more than 2 percent of its reserves in common stocks. Most firms have had to establish New York subsidiaries in order to comply.

ANOTHER significant interstate trade barrier: the severe restrictions on the mobility of professional labor. One study found more than 2,800 such laws. For example, "about 27 states require that a dentist take the exams in the state where he wants to practice, no matter how long he practiced in another state," says American Dental Association attorney Richard Berry.

Georgia requires all dentists to take a "practical, three-day exam" before they can practice in that state. A spokeswoman for the state examining board explains: "We found a lot of states don't have our standards. It takes more time to investigate an applicant's background than to just make him take the test."

Craig counters: "These licensing restrictions are supposed to protect consumers from unethical professionals, but in reality, when you let fewer new people into the state, competition is kept low and income stays higher."

Why have such barriers not been knocked down by the Supreme Court? "The High Court has ruled very narrowly in most interstate trade cases," Craig says, "preferring to force the Congress to legislatively enforce free trade among the states. Congress, however, has not acted."

The Court has ruled that states may not impose tariffs on out-of-state goods, Craig says, but the states have gotten around that by placing complex administrative restrictions on them. These restrictions burden the states with enforcement costs and bring in no corresponding tax revenue.

"Potential customers, both business and consumers, are the big losers in this arena," Craig says, "since they pay higher prices for goods where competition has been restricted. Further, as other states retaliate, firms lose potential out-of-state business."

The most common justification for restrictive laws is to keep jobs within the state. "The problem," says Craig, "is that jobs are being kept at the expense of alternatives within that state. The extra expense customers pay is not generated from extra economic activity. It comes from the money people would have spent on other goods, at other firms. Thus the job protection comes by reducing jobs in other industries.

"The bottom line is that scarce economic resources are not used to their best advantage. If the goods from one state are kept out of another, the potential customers must pay more for substitute goods. Had trade been allowed, the savings could have been spent on other goods, which would have created more jobs and income." NB

Being Reasonable Is Not Always Rational

Understanding how you really make business decisions could improve your follow-through.

By William Hoffer

ILLUSTRATIONS: WILLIAM COULTER

"I MAKE DECISIONS by the seat of the pants," admits Robert Berinson, president of Berinson Designs, of Silver Spring, Md., a small firm specializing in decorative planters. "What other way is there?"

Most business people prefer to think their decisions are more rational than this. All of us would like to believe we are reasonable, objective beings, capable of altering decisions after weighing solid data. Psychologists are learning, however, that most of our decisions are not rational, but what we really want them to be. Most of our decisions *are* made by the seat of the pants.

These findings lead to a paradoxical conclusion. As we grow in our understanding of the emotional factors underlying our "rational" decisions, we learn to develop a healthy skepticism about our ability to gather facts and judge them. This skepticism can, in turn, make us more reasonable about the results of our decisions. They are not so much right or wrong as unique to our business personality. That will make it easier to reverse a poor decision or capitalize on a good one.

Recent studies at Stanford University and at Decision Research, a Eugene, Ore., consulting firm, reveal several subtleties in the decision making process:

• **Less information goes into decisions than we believe.** We assume that the more voluminous the data, the more rational the decision. A Decision Research study of personnel managers showed this to be false. Personnel officers tend to believe that their hiring decisions are based on a wide variety of variables: candidates' experience, education, references, appearance, communication skills, punctuality, personality and many other factors. But the study showed the personnel officer is likely to base a decision on only one or two of these factors.

Most of our decisions use only a few criteria, regardless of the extent of research. Our brains find it difficult to sort through numerous complex variables, so we automatically simplify what goes into a decision.

• **We cling to the lessons of the past.** Decision makers believe the past will aid us in predicting the future. This faith in the repetitive nature of life supplies jobs for many economic fortunetellers, but it can trap the business person who has to react to new challenges.

"When I first started in business 15 years ago, buying was easy," recalls Edwin Stern, president of Bell Clothes of Front Royal, a small-town men's store in Virginia. "There were certain basic styles that would always sell."

Stern stocked those styles, assuming they would continue to be profitable. It took him a few seasons to realize that men's fashions had begun to change from year to year, and adjusting to the new situation was tough.

Stern had to teach himself that the decisions of the past were not always valid in a volatile market. He had to stock one-season men's fashions, correctly assessing the market six months or more in advance.

How does he do it? "You just have to take a chance," he admits. "You ask the salesmen what is selling elsewhere, but you can't always trust them. You have to guess. Sometimes it works, and sometimes it doesn't. I can look around the racks and see my mistakes."

• **We are more sensitive to negative consequences than positive ones.** "Everybody's afraid to be a failure," laments Jack Goeken, the radio repairman from Joliet, Ill., who found-

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ed MCI Communications, left it to the guidance of William McGowan after it made him a millionaire and is now the driving force behind Airfone, an Oak Brook, Ill., company that is putting telephones onto airliners. "They're afraid to try something new because if it doesn't work someone will say, 'Why did you do it?' " Goeken adds. "To me, it doesn't matter how many times you fail. All you need is one good success."

Most of us do not possess this blind entrepreneurial gusto. Suppose you were offered a speculative deal, in which the chances for success were 50-50. You had to invest $10,000 in order to earn a potential profit of $20,000. Simple statistical probability would show that if you made 10 such deals you would lose $50,000 on half the deals, but you would profit $100,000 on the other half, for a net gain of $50,000 on all 10. But studies by Amos Tversky, a professor of psychology at Stanford University, have shown that most people will find some reason to forgo such deals. They are more concerned about losing $10,000 than about winning $20,000.

Similarly, says Tversky, we get hung up on the words "cost" and "loss." What business person would refer to an expense as "the loss of doing business?" And yet, a $10,000 cost is as expensive as a $10,000 loss. His example suggests that we could learn to use the two words interchangeably, so as not to allow our emotional reaction to the words to cloud our judgment.

• We believe there is a rational explanation for any decision's success or failure. As we analyze the outcome of a decision, we are uncomfortable unless we can find solid evidence to explain what happened. We have difficulty in accepting the chaos of life as an answer.

Baruch Fischhoff, research scientist at Decision Research, warns that there is an inherent trap in any decision postmortem. We can never reconstruct the past with unerring accuracy.

"In hindsight, people consistently exaggerate what could have been anticipated in foresight," Fischhoff explains. Looking back, they assume that decision makers should have seen what was about to occur and therefore should have predicted it. When second-guessed, what were merely unfortunate decisions appear to be the result of incompetence.

Fischhoff advises comprehensive recordkeeping as a way of avoiding future mistakes. When you are faced with a critical decision, keep a detailed journal of the decision making process. Future analysis of the outcome can then provide a better understanding of why the decision was made.

This was the solution devised by Deane Beman, commissioner of the PGA (Professional Golf Association) Tour, Inc., in Ponte Vedra Beach, Fla. A former professional golfer himself, Beman oversees 79 annual tournaments.

At each event his officials are required to make dozens of rulings on the spot that affect professional golfers' incomes. From week to week and even from day to day, those decisions used to show wide variance.

When he took over as commissioner 11 years ago, he says, "We reinvented the wheel every year at each tournament." One of the first things he did was put together a tournament book for each event.

"Take the Western Open, for example," he says. "Today, our tournament book shows how everything went over the past five years. How have we always marked the hazard on the fifth hole? During a tournament, whenever an official makes a ruling, he has to write a report that tells the time, what hole, who the golfer was and the nature of the ruling. The rules official reviews these every day. It brings consistency."

• Once having made a decision, our minds begin to convince us that it was right. Psychologically, it works like this: You decide to relocate your office from the downtown business district to the suburbs. Then your mind begins to emphasize the positives and dismiss the negatives. You relish the ease of commuting; you discount the inconvenience of getting to downtown appointments. You boast about the cheaper rent; you rarely think about the cost of messenger service. In general, you persuade yourself that the decision was correct.

In truth, the decision may have been neither correct nor incorrect. It simply was.

The biggest lesson you can learn from all of this, says Fischhoff, is to stop pretending to yourself that your decisions are rational.

"I'm usually uncomfortable with the terms 'rational' and 'irrational,' " he says. "Sometimes we think that if someone doesn't make decisions like we do, he's irrational. We find that what people do is not necessarily what an economist or a philosopher would call rational. On the other hand, it's usually reasonable."

Certainly you should arm yourself with data and with sound advice, says Fischhoff. But he encourages you to remember that you are deeply influenced by your human tendencies.

You are, in sum, an irrational human being.

The trick, says Carnegie-Mellon University psychology professor Herbert Simon, is to make decisions that are satisfactory to you, that fit not only the facts, but your own emotional makeup. And then, adds Airfone's Goeken, acknowledge the seat-of-the-pants nature of the executive's job and refuse to waste additional emotional energy on the decision.

To Goeken, the basis for a decision is not as important as the resulting action. "Why worry about whether your decision is right once you've made it?" he asks.

Success or failure may depend on the quality of the work that follows the decision. Goeken, for example, resigned as president of MCI in 1973, shortly before the company exploded into prominence. Some might call that a wrong decision. But Goeken worked hard to develop other ventures, building yet another successful career.

Once the decision is made, he advises, forget about the rationality of it and "put in the effort to make it the right decision." NB

Alzheimer's and Your Employes

By Carol Dilks

AT SEVEN o'clock every morning, while many of Al H.'s friends are setting out for their morning jogs, he sets to work at an hour-long task: the care and feeding of his mother. Bedridden for three years, she is a limp parcel that he must carefully wash and diaper. He talks to her, though she no longer can make sense of what he says, while he spoons some gruel between her withered lips. Then he braces himself for another day of work and another night of feeding and cleaning.

You can ease an employe's burden by helping him find aid—like that at this day care center—for a relative with Alzheimer's.

Al refuses to send his mother to a nursing home. He does not know how much longer she will be able to live like this. He hates himself for hoping it is not too long.

Alzheimer's disease affects close to 2 million Americans as victims—and for each victim, whether a parent or a spouse, there is a care-giver and a whole family surrounded by turmoil.

Like many employes in his position, Al has chosen not to confide his situation to his boss. As a salesman, he is fortunate that his schedule is flexible enough to allow for responsibilities at home. Most employes are not that lucky.

Perhaps one of your own employes is in Al's position and you do not even know it. But you may have suspected something was wrong.

An employe with an Alzheimer's victim at home may find being punctual a constant problem, and the number of days out of work will mount as his or her presence is increasingly needed—to calm the victim, for example, or to interview professional care-givers. The employe will probably be tired, irritable, distracted, tense and depressed.

Studies at the Duke University Center for Aging have found a 22 percent increase in the use of prescription drugs for depression, tension and sleep disorders among primary care-givers. Twenty-eight percent of the respondents in the study reported increased alcohol consumption.

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The person caring for an Alzheimer's victim will be frightened by the unknowns of the illness, only recently recognized as a true disease and not a natural part of aging. Alzheimer's causes deformities in the brain that block the normal message systems, so memories cannot be retrieved. In time, signals to the muscles also get scrambled. Victims become confused, disoriented, weak and incontinent. After a period of time—maybe two years, maybe 10—the victim dies, often of pneumonia or malnutrition.

A VICTIM OF Alzheimer's may become suspicious and aggressive or depressed and withdrawn. He may retain the words of old songs but forget his wife's name. He will exhaust, hurt and irritate everyone around him before he sinks into a second infancy.

"It's not quite as nice as dying," says Dr. Rachel Pruchno, senior research psychologist at the Philadelphia Geriatric Center. "With death, you pick up your own life and go on—with Alzheimer's you have to deal with the loss of the person you once knew, but he's still there, demanding attention."

The major problem care-givers face, according to the Duke University studies, is loss of sleep. The Alzheimer's victim routinely has day-night reversal problems. He naps during the day but springs out of bed minutes after being tucked in at night, so the care-giver must put him back to bed. This may happen a dozen times before morning.

If there is any good news at all, it is that there are ways to help those who are giving help. As an employer, you may be able to extend benefits to elderly dependents who need nonmedical care.

Certain New York banks have already put such programs into effect. Chase Manhattan offers a capital accumulation plan, giving the employe a bonus amount that he or she can use for immediate dependent care or save, tax-free, for use on dependents at a later date. At Chemical Bank, employes receive stipends toward any uncovered medical or dependent care expenses, plus the option of using half their profit-sharing allotments for these expenses.

You can help by posting information about support groups for families of victims. The Alzheimer's Disease and Related Disorders Association (360 N. Michigan Avenue, Chicago, Ill. 60601; phone 800-621-0379) has more than 100 chapters nationwide. It can supply fact sheets, names of diagnostic and care centers, contacts for family support groups and reading lists. Your local chapter can arrange free lectures and seminars, and you may want to donate meeting space for such an activity.

The National Support Center for Families of the Aging (P.O. Box 245, Swarthmore, Pa. 19081; phone 215-544-3605) distributes a seminar program of cassette tapes and workbooks for small groups. Affected employes could make good use of these materials.

Contact your local agency on aging to find out what services are available in your community. Information and referral services, transportation aid or friendly visitors may be available to ease the burden on the employe.

Employes could be given access to your organization's legal department, where they could get needed clarification on financial and estate matters.

Most important, try to allow for a bit of flexibility in the schedule of an employe caring for an Alzheimer's victim. He is living from day to day, from crisis to crisis. Your understanding may be crucial to helping him hold on until it is over.

The Government's Shopping List

Many small businesses—and a lot of large corporations—are eager to find out how to tap one of the biggest markets in the country, the federal government.

Uncle Sam spent more than $182 billion on purchases from companies during the 1984 fiscal year. How do businesses keep up with which government agencies buy which products? And how do businesses know which of their own competitors are selling to the government?

Uncle Sam, it turns out, is a good source of information. The General Services Administration's Federal Procurement Data Center offers a standard report each quarter that offers basic information about government purchases of more than $10,000—more than $25,000 in the case of the Defense Department.

Additionally, special reports, usually costing $250 to $400 depending on the nature of the information requested, can be ordered to look at specific areas of government spending. Many companies order special reports to obtain precise information—available nowhere else—about which agencies buy certain products in particular regions. Pricing of the reports is based on the number of fiscal years involved and the complexity of the information.

The centralized information may be placed on-line for direct computer access in the future. That would help in getting time-sensitive information more quickly, says Robert Phillips, vice president of Mid-East Services, Inc., of Dunn, N.C., a $10 million firm that specializes in government food service and refuse collection contracts. The reports provide a way to "check on my competition," Phillips says.

For more information, write Federal Procurement Data Center, 4040 N. Fairfax Drive, Suite 900, Arlington, Va. 22203 or call (703) 235-1326.

President Reagan presents a National Technology Award to Bob O. Evans of Boeing after giving a similar award to Joseph Sutter of IBM (center).

Getting Graphic

More and more business presentations are including graphics to illustrate important points—and the rapid increase in personal computers in offices has meant a lot of those graphics leap from computer screen to overhead projector.

About a million U.S. business people were using personal computer graphics at the end of 1984, and about 10 million will be doing so in late 1989, projects Neil Kleinman, a vice president at International Data Corporation, a Framingham, Mass., industry analyst company. The field is ripe, Kleinman says, for a company to become a major supplier of graphics software.

Kleinman's views were expressed at a Hewlett-Packard announcement of a series of software products that doubles to about 560 the number of software packages available for its personal computers. The new packages include some written by the company's own personal software division as well as by independent software publishers.

Hewlett-Packard's software includes Drawing Gallery and Charting Gallery, aimed at the growing market for managers' presentations.

Honoring Innovation

To honor the impact that pioneers in technology have on the economy, the government five years ago established an award to give presidential recognition to those exemplifying a combination of technological innovation and entrepreneurship.

This year President Reagan has presented the first awards to Frederick P. Brooks Jr., Erich Bloch and Bob O. Evans of International Business Machines Corporation for developing the IBM/360 computer. Awards also went to Steven P. Jobs and Stephen Wozniak of Apple Computer, Inc., for developing the Apple II personal computer; Marvin M. Johnson of Phillips Petroleum Company for developing a process that accounts for about half the gasoline produced in the United States; and Ralph Landau of Halcon-Scientific Design Group, whose company has become a major source of new petrochemical processes.

Also: John T. Parsons and Frank L. Stulen of the John T. Parsons Company for work in numerical control of machines and industrial processes, and Harold A. Rosen and Allen E. Puckett of the Hughes Aircraft Company for their roles in producing geostationary communications satellites.

Others were Joseph F. Sutter of the Boeing Commercial Airplane Company for playing an instrumental role in developing three generations of jet airplanes for the airline industry, and AT&T Bell Telephone Laboratories, Inc., whose president is Ian M. Ross, for its series of advances, including long-distance television transmission, the transistor, semiconductors, lasers, the Telstar communications satellites, digital switching and lightwave communications.

The awards are expected to become an annual way to recognize technological innovators.

—Mike Lewis

A License To Appeal

Popularity—whether it's Buster Brown's or Mr. T's—can sell your products.

By Sharon Nelton

TURN-OF-THE-CENTURY cartoonist Richard Fenton Outcault caught on fast when the Brown Shoe Company asked to purchase rights to use the name of Buster Brown, the popular comic strip character he had created. While the shoe company used the name to launch its Buster Brown line of children's shoes at the St. Louis World Fair in 1904, the savvy Outcault set up a booth and peddled additional trademark rights to any merchant who came along (at prices ranging from $5 to $1,000).

A deluge of Buster Brown products followed—at least 50 at one time, ranging from harmonicas to soap. Meanwhile, the Brown Shoe Company promoted the new shoes by sending throughout the country a succession of midgets, dressed like Buster and accompanied by dogs all called Tige. They appeared in theaters, department stores and shoe stores.

It was a happy coincidence of names—licensing in the United States might never have begun had Buster's last name been Smith.

Walt Disney was not quite so swift as Outcault in spotting such an opportunity. In 1927, when his Oswald the Rabbit appeared on a candy bar wrapper, he thought of the publicity as payment enough.

Two years later, with Mickey Mouse, he wised up. According to Pat Upton in *Make Millions in the Licensing Business!* (Monarch Press, $7.95), Disney was paid $500 in 1929 for the first Mickey Mouse license—for school notebooks. By 1931 Disney had granted 18 licenses, also for small amounts. One licensee so seriously underestimated the demand for its Mickey Mouse dolls, says Upton, that they were as hard to get in their time as Cabbage Patch Kids dolls were in 1983.

Given that we live in an era when almost everything seems to be sold on the cachet of someone—or something—else's identity, it is hard to believe that licensing has only recently become regarded as a hot growth industry. We have stuffed toys, bed linens and best-selling books bearing the likeness of Garfield the cat; Mr. T cereal; Kellogg's Fruit Loops plastic ponytail holders; Playboy sunglasses; McCall's patterns featuring fashions based on the hit ABC-TV series "Dynasty"; LifeSavers on wastebaskets and Michael Jackson on virtually everything.

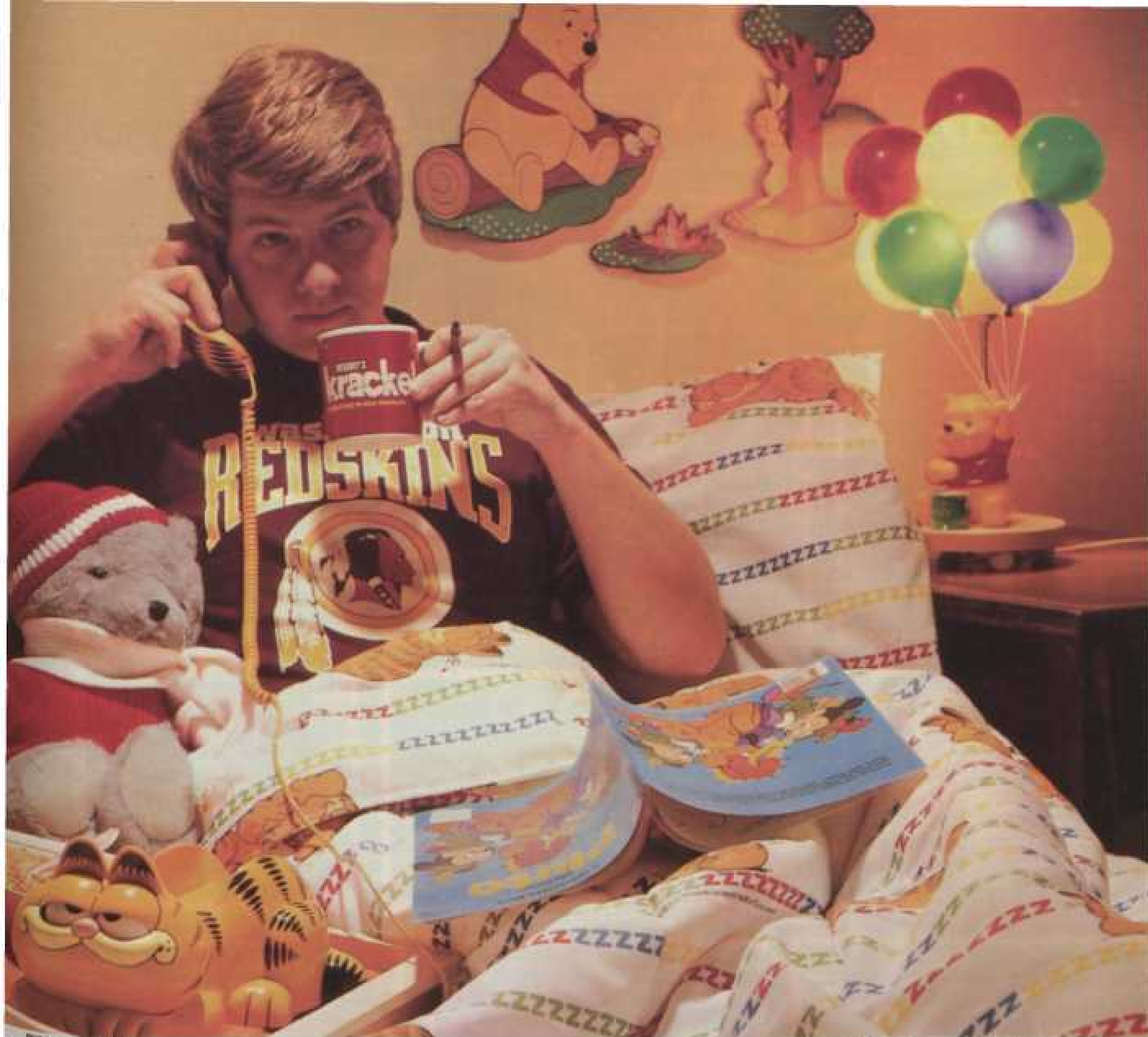
Could Shakespeare have been wrong when he wrote, "But he that filches from me my good name/Robs me of that which not enriches him"?

For enrichment, in most cases, is what it is all about. Gerald J. Alpert, president of Licensed Ventures International in New York, speaks of the "old licensing" before 1977 and the "new licensing" since. The 1977 watershed year marked the release of the movie "Star Wars" and the skillful advance licensing and promotion of all the products the film engendered. Their success made everyone see dollar signs.

In 1978, worldwide retail sales of licensed products were $6.5 billion, according to Arnold Bolka, executive director of the Licensed Merchandisers Association and publisher of *Licensing Letter*, a monthly industry newsletter. Last year, the industry had reached $40.1 billion and, says Bolka, it could easily exceed $75 billion by 1990.

WITH THE PRIMARY exception of the Disney organization, which engaged pioneer licensing agent Kay Kamen in the 1930s and established its own character merchandising division in 1949 when Kamen died, the licensing business had until the late 1970s been a haphazard one, limited largely to movies, television and newspaper syndicates. It was built happy accident by happy accident on characters or names that were already popular.

At a recent American Woman's Economic Development Corporation con-



PHOTOS: RHODA BAER

The avid fan can eat, drink, sleep on (or with), read by, decorate with and chat via his favorite characters in licensed form.

Comic strip character Buster Brown launched a children's line for Brown Shoe Company in 1904. Today, stars of the television program "Dynasty" have inspired a host of products, including McCall's dress patterns.

ference, Naomi B. Warner recounted how in the mid-1970s the publishing house she works for, Harry N. Abrams, bought rights to a Dutch book called *Gnomes* for a mere \$4,000. Little did Abrams anticipate the reception the book would receive. The sale of a million copies in two years and the appeal of the book's creatures themselves opened up the opportunity for Abrams to create a licensing division. Warner, who was tapped for the job, learned by doing and has since started her own licensing consulting business.

Even the licensing of Charles M. Schulz's Snoopy, which ranks with Mickey Mouse and Donald Duck among the all-time most lucrative licensed characters, came about only after the endearing dog had won a following.

But "Star Wars" showed that licensing plans could be laid before a property was launched. Successes followed, as in the case of American Greeting

Cards' creation of Strawberry Shortcake for the purpose of licensing, and so did disaster, as in the case of the film version of "Annie."

Gerald Alpert, a graphic designer with degrees in marketing and law, has nurtured Licensed Ventures International on the growing sophistication of corporations. Although once they thought of the free use of their names and logos and trademarks as good will and cheap publicity, often handled through "permissions" departments, they are not giving such rights away any more.

But profit is not the only motive for corporations to enter licensing, says Alpert, who represents such corporate "spokescharacters" as Tony the Tiger (Kellogg's Frosted Flakes) and the Campbell Kids, as well as Nabisco, Inc., and the *New York Times*. Licensing offers companies greater legal protection of their trademarks, he says, and, because licensing programs are carefully planned, they help companies make more impact on consumers.

DEMONSTRATING how far the industry has come, United Media in February launched a new comic strip, "Robotman," about a lovable robot, *after* it sold rights to the character to nearly 40 manufacturers in the United States and Canada. The syndicate had signed up more than 200 newspapers before the launch and Robotman, conceived by British composer-performer Peter Shelley, is slated for television shows in the spring and fall.

United Media already has two of the industry's legendary properties—"Peanuts" and Garfield. But after watching how American Greeting Cards had "manufactured" the popular Strawberry Shortcake, says United Media President Robert Roy Metz, "we said it doesn't look like licensed characters are going to develop in the same fashion as they did historically."

It took about 25 years to turn "Peanuts" into what Michael V. Georgopolis, senior vice president-licensing for United Media, calls a "worldwide powerhouse." The first 15 years were spent establishing it as a comic strip, followed by more years of building it through television.

"That development timetable was compacted down to about 3½ years" with Garfield, says Georgopolis. Now, using all the media simultaneously—newspapers, television, books and music—he and Metz hope to compact the timetable yet again—into several months.

PHOTO: LICENSED VENTURES INTERNATIONAL LTD.

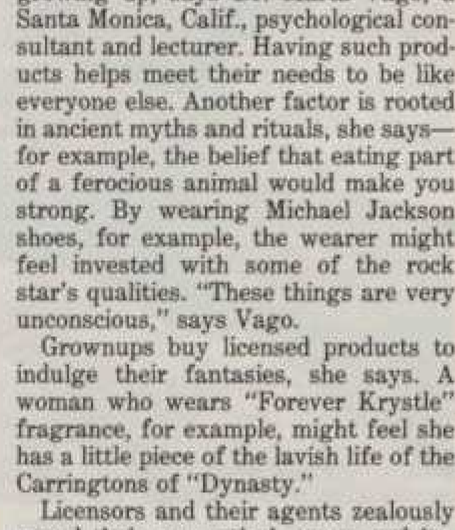
Corporate licensing agent Gerald J. Alpert sells such company trademarks as Tony the Tiger and the Campbell Kids.

Why do people flock to licensed merchandise? For teen-agers it is a part of growing up, says Dr. Marta Vago, a Santa Monica, Calif., psychological consultant and lecturer. Having such products helps meet their needs to be like everyone else. Another factor is rooted in ancient myths and rituals, she says—for example, the belief that eating part of a ferocious animal would make you strong. By wearing Michael Jackson shoes, for example, the wearer might feel invested with some of the rock star's qualities. "These things are very unconscious," says Vago.

Grownups buy licensed products to indulge their fantasies, she says. A woman who wears "Forever Krystle" fragrance, for example, might feel she has a little piece of the lavish life of the Carringtons of "Dynasty."

Licensors and their agents zealously guard their properties' names and images. Alpert will not represent tobacco or liquor companies. So many of the 1,000 products he represents are marketed for and to children that he fears even an accidental linkage with tobacco or alcohol could tarnish his clients' wholesome image.

PHOTO: UNITED MEDIA



United Media's Michael V. Georgopolis hopes Robotman (second from right) will match the success of "Peanuts."

Licensees generally pay royalties in the 5 percent to 10 percent range, but this can vary, depending on such things as type of merchandise and expected sales volume.

And although success brings its rewards, Jerry E. Gordé, president of Virginia Textiles, Inc., in Richmond, found it can bring headaches, too. His $7 million firm won the right to manufacture Michael Jackson T-shirts last year. That was fine. But, valuable on the streets, the T-shirts in Gordé's warehouse became a constant target of heavy-duty thieves and, for the first time, Gordé had to bring in armed guards, a move that pleased neither him nor his employes.

Jerry Alpert says it can take a year for a licensor (and agent) to realize any income from a licensed product. In some cases, it takes longer. New York illustrator June Amos Grammer was thrilled in January, 1983, when a division of Lenox, Inc., offered her a modest advance for designs for a line of antique-style china dolls that would be sold at prices ranging from $250 to $500. Grammer blames her lack of experience for not understanding how long it would take her and Lenox to get the project off the ground. So far, she has designed more than a dozen dolls and has yet to see any royalties.

STILL, THERE ARE unexpected pleasures, ones that have nothing to do with money. About three years ago, United Media's Bob Metz recalls, he and Mike Georgopolis were visiting a licensee in Nice, France. It was La Maison Snoopy, a shop that carried "Peanuts" items. They were there during lunch, when the store was closed for two hours, but they could see out its front greenhouse-like window.

"People would be window shopping, sometimes with children, sometimes just by themselves," says Metz. "And as they walked by and looked at the display of Snoopy and Charlie Brown products, these smiles would come on their faces. Or a child would see it and he'd laugh and touch mommy or daddy, and the parent would turn and smile."

Metz says he doesn't want to hype you when he tells you this, "but it was just a wonderful experience to be there and say, 'Hey, it's kind of nice to be connected with this kind of business.' " NB

To order reprints of this article, see page 81.

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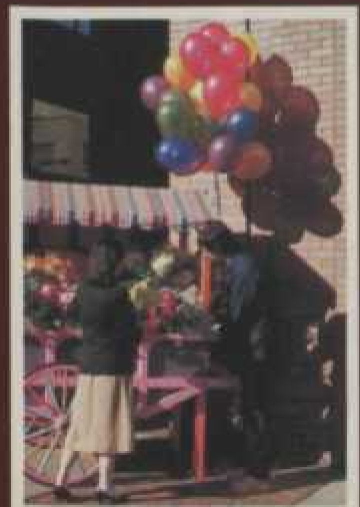

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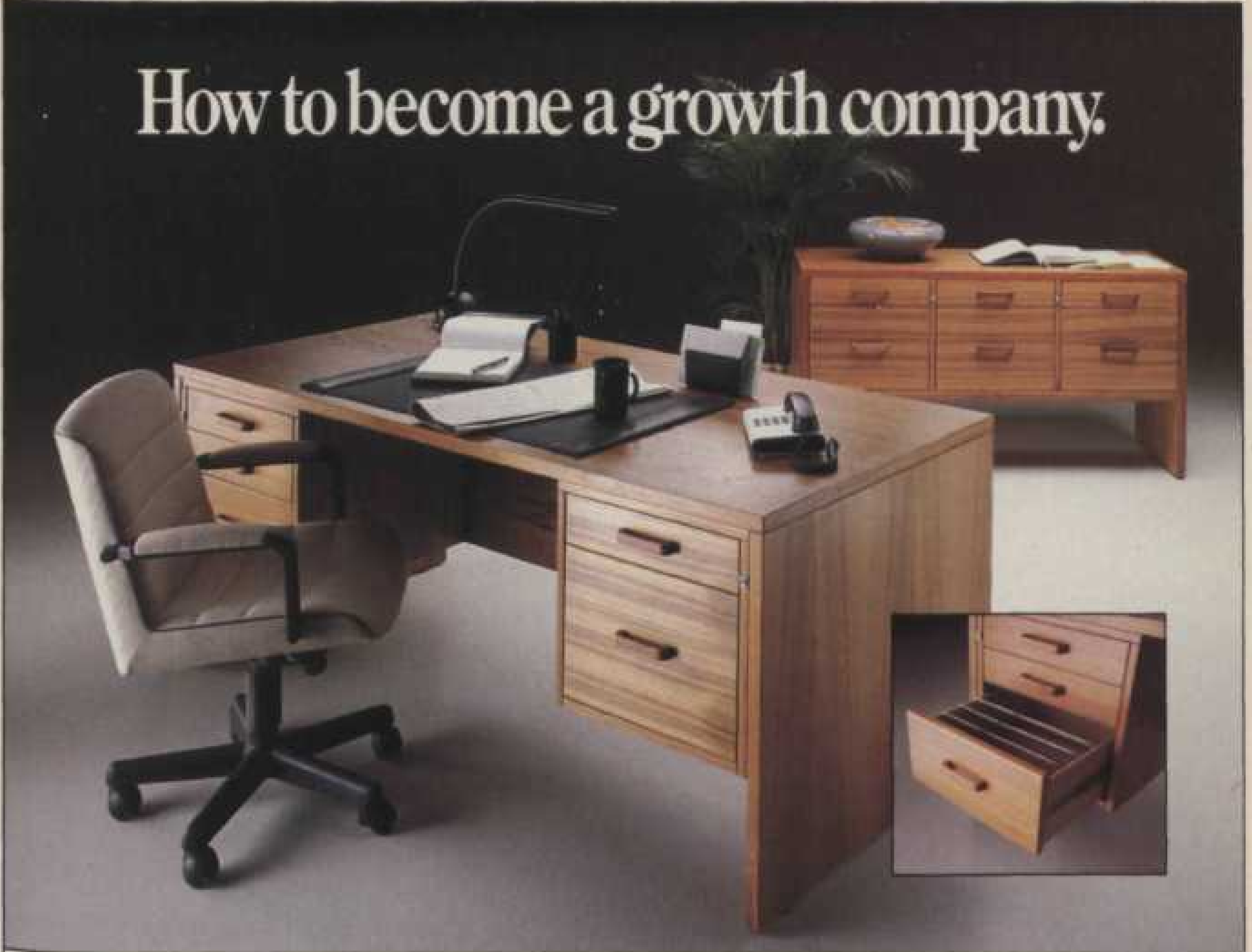

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How To Ring Up

INCREASING SALES at less expense—that has a nice ring to it. Using the same method to sell a new banking service to depositors or agricultural products to small farmers or duplicating supplies to offices has an even nicer ring.

The ring belongs to the telephone, since the late 1970s an integral part of the marketing plans of hundreds of companies as diverse as Montgomery Ward, Citibank, Procter & Gamble and A.B. Dick.

During an average business day, these businesses will place 14 million sales calls, usually to potential customers the salespeople have never met. Most of the calls will be well received. About half those called will listen to the entire presentation, and more than 6 percent—at least 900,000 people a day—will place an order.

Each week, telemarketing rings up about $275 million in sales. That adds up to more than $14 billion in products and services in a year.

The explosion in telemarketing can be traced in part to higher costs of traditional marketing techniques. Mailing costs have risen as much as 70 percent in the last six years, while sales force costs have jumped 75 to 80 percent. Today the average cost of an in-person industrial sales call exceeds $206.

DEVIN SCOTT *is president of Campaign Communications Institute, a New York-based international telemarketing firm.*

But telemarketing's broad use by both large and smaller organizations is rooted not so much in its favorable costs as in its efficiency and effectiveness.

As a marketing medium, the telephone is the most personal direct response method outside of a face-to-face sales call, allowing you to offer immediate and authoritative answers to a customer's questions, overcome sales resistance based on misinformation or misunderstanding, and take an order.

The ability to generate a response on the spot offers you other benefits. For example, you can test an offer, a new product price or a creative strategy with only a few low-cost calls and make revisions before launching a full marketing campaign.

Can you make telemarketing work in your organization? Yes—as long as you are willing to plan, pay attention to details and approach it professionally.

Here are the key steps you must take to launch a telemarketing campaign:

Develop a complete marketing plan. This should include an analysis of your current competitive situation, your objectives, and real and potential threats and opportunities, as well as a decision on tactics.

For example, a national manufacturer of duplicating equipment and supplies found that rising sales force costs had made it unprofitable to continue to serve many of its smaller accounts with salespeople. Breaking with tradition, the company developed a marketing plan that substituted regular telephone contacts, to service marginal accounts.

The company wanted to retain the customers and turn them into profitable accounts. The risk of losing many accounts by eliminating the personal sales call was reduced through a thoughtfully planned introductory phone contact that explained the new program and pointed out how it would make ordering products easier and reduce potential product shortages.

Prepare a realistic, detailed budget. Telemarketing permits you to maintain tight control over costs. You can establish the precise cost-per-inquiry or cost-per-sale and easily compute the break-even point.

A well-managed operation can result in each caller (termed a "communicator" by telemarketers) reaching 3.5 to 7 business decision makers per hour, at a cost of $6 to $10 per call. This is not to say telemarketing is cheap—but it is considerably less expensive than a sales visit. Telemarketing costs may include equipment, script preparation and printing, management control sheets, call list acquisition, salaries and training.

Set target dates for the campaign launch. This might seem elementary, but setting firm dates puts everyone involved on the same schedule and helps ensure a well-planned start.

Design and develop the printed pieces and marketing support materials. These may include advertising and direct mail pieces that are part of your overall marketing efforts.

In most campaigns, the telephone's effectiveness increases when it is supported by other media, such as direct mail and print or broadcast advertising. Multimedia marketing efforts improve the results from each medium.

Analyze the market and target your customers. Your telemarketing campaign's success will depend on zeroing in on individuals with the greatest potential interest in your product or service. Among your best prospects are your past customers. So are decision makers who have previously purchased from others by telephone, because they

Sales by Phone

By Devin Scott

already show a predisposition to transact business by telephone.

Knowing the characteristics of present and past customers helps you put together a description of your target customer.

Once you have clearly profiled your target customer, you can obtain additional names from brokers who will select lists with demographics that match those of the target audience. List brokers can be found in the Yellow Pages under "Mailing Lists" or by contacting the Direct Marketing Association, 6 E. 43rd Street, New York, N.Y. 10017.

There are more than 200,000 lists that you can rent. The cost varies widely, with highly specialized lists running as much as $90 per thousand names. Such lists cover a broad range of groups from home gardeners, computer buffs and glider pilots to people who have bought a home in the past year, coin collectors in Ohio or women with incomes over $50,000 a year. Lists may be segmented by ZIP code and neighborhood and clustered by such criteria as income, type of dwelling or car, lifestyle and education.

Create a caller script. Each call should be based on a fully written and tested script. Often, several test scripts are developed before the best is selected for a full campaign. A carefully devised script gives you the confidence that each prospect is being contacted in a manner consistent with the standards you have set for your company.

Build realistic customer benefits into your scripts. The best sales situation enables you to provide a valuable service for the buyer.

The basic premise behind successful telemarketing is letting the prospect know concisely and accurately what is being offered and then acting swiftly to fulfill the prospect's desires regarding the offer. The persuasion needed is applied in a gentle, logical, truthful manner.

Anticipate a prospect's questions. Along with the prepared script, the telephone communicator will often have a flip chart of answers to anticipated questions or objections. For example, a Southern bank introducing a "pay bills by phone" program prepared answers to an extensive list of expected questions such as:

- How fast will the bank pay my bills?
- When can I call? During business hours only or also in the evening when I am home?
- How do I know if the bills are paid?
- What if I make a mistake, and as a result the bank pays the wrong bill?

Prepare forms for recording results of each call. The forms can also be used to develop important customer and marketing data. They provide for tight controls and ongoing supervision of the marketing effort.

Today's telephone selling requires the application of production line technology to a people-intensive service activity. This means creating work control forms that constantly provide you with a record of how each communicator is performing, who is being called and the results of each call. Such forms include:

- Call cards, which provide a full record of each call.
- Tally sheets, which show at a glance the results of each communicator's calls each hour or each day.
- A master log sheet, which tallies each day's call cards, providing a cumulative overview of program results.

Train the caller. Experience has shown time and again that telephone communicators can handle complex products when they have been properly trained and you have supplied them with backup material.

Though it takes a certain amount of skill to follow a telephone script and make it sound natural, the skill can be learned by many people. On the other hand, an ability to sell based on an individual's own approach is much rarer.

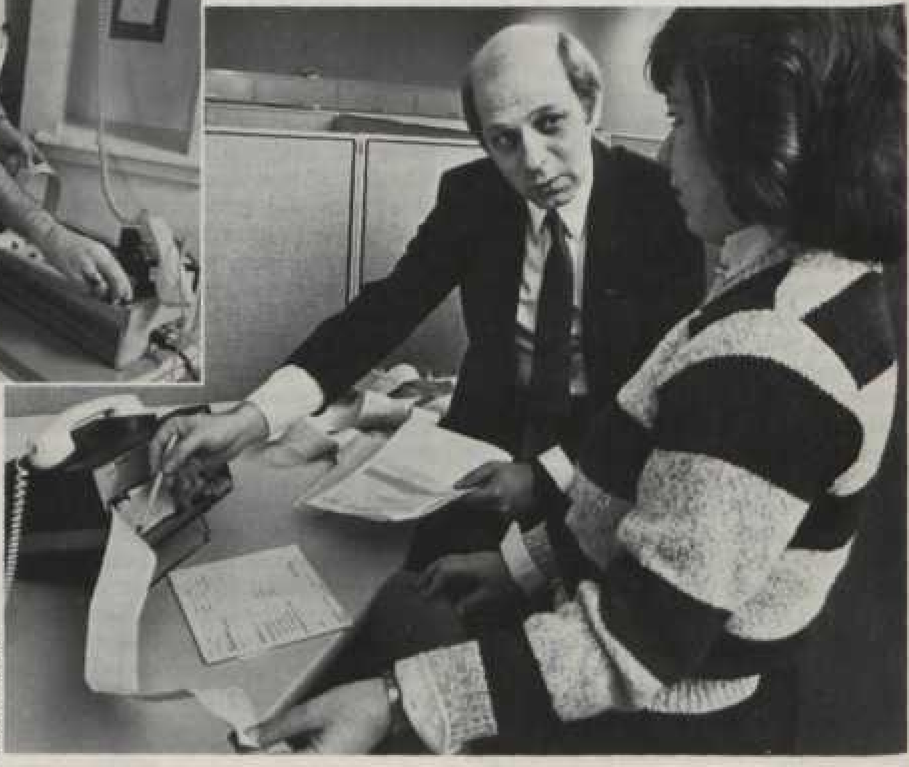
Training should include rehearsal and simulated calls—as well as information sessions on the product or service being offered. Your aim is to develop a successful, measurable and predictable campaign. The communicator must be trained in how to use and follow the script—and how to listen as well as speak. He or she must be able to hear and record the prospect's attitudes and decisions. The scripted approach allows you to test the effectiveness of your calls and permits statistically valid projections for an ongoing program.

A well-run telephone campaign offers you advantages that can be matched—at greater cost—only by a sales visit: person-to-person communication, immediate feedback and rapid testing of offers and strategies. It enables you to reach far beyond your immediate customer base. It can enhance and complement other marketing efforts. Above all, it can increase your total sales significantly on a cost-efficient basis.

In essence, telemarketing epitomizes bottom-line, pragmatic business planning.

PHOTO: T. MICHAEL KEZA

Getting to the Heart Of Pet Problems



From his Long Island Cardiopet office, David Jacaruso (right) provides diagnostic service via a telephone transmitter to an animal hospital in the nation's capital.

Seeing a television broadcast about a dog with a heart pacemaker led David Jacaruso to start a company that in five years has become what he claims is the largest veterinarian services firm in the world. He is chairman and CEO of Cardiopet, Inc., of Long Island, N.Y. The company dominates the field of long-distance testing laboratory services by serving 5,000 veterinarians in the United States, Canada and Europe. It is also beginning to supply them with drugs and equipment.

Jacaruso's first business was for human patients. Trained in computers and public health, Jacaruso, then 32, was administrator at a Brooklyn hospital. A fellow administrator, Steven Rabinovici, 24, who had studied law and public health, in 1977 joined him in starting a part-time service for heart patients in nursing homes.

Using space-flight telemetry techniques, the two men performed monthly remote checks on patients' pacemakers to test when batteries needed to be replaced. In each nursing home a nurse placed a transmitter on the patient's chest and sent signals by telephone to an electrocardiogram machine in Rabinovici's basement in Brooklyn. Printed results were returned the next day to the home.

One Sunday evening in 1979, Jacaruso was watching TV and saw the dog with the pacemaker. It gave him an idea. Veterinarians generally lack the hospital access that human doctors have. Office electrocardiogram machines are expensive. The animal doctors might welcome a long-distance service of the sort he had developed for nursing homes.

The next day the two partners located the animal cardiologists involved in the broadcast, Dr. Lawrence P. Tilley and Dr. Robert Cohen, at the Animal Medical Center in Manhattan, and arranged a test on hospital animals. Rabinovici went back to Brooklyn to operate the receiver and returned with the printouts.

"Dr. Tilley was getting good, clear readings like he had never seen before," says Jacaruso. "He found the system to be very diagnostic."

After more tests, the doctors asked for 40 more transmitters to lend to veterinarians across the country as a test. The response was quick.

"This was a virgin market," Jacaruso says. "Nobody else was doing this."

Most of the veterinarians wanted to pay to keep the transmitters, and they spread the word to colleagues. Orders came pouring in at $150 for each transmitter (they cost the partners $75) and $10 per transmission.

The partners knew they had a good idea, but also knew they had to give it their full time and attention—and find some capital.

They asked the two cardiologists to join them in setting up a corporation. They chipped in equally to a $10,000 startup fund.

A mailing to 5,000 veterinarians brought nearly 1,000 replies, each with a check attached. The company moved into a Brooklyn storefront, Jacaruso and Rabinovici quit their hospital jobs, and soon the two doctors also came on full time. The partners sold their nursing home business at a nice profit.

The veterinary service business began to expand in several directions. Jacaruso designed a computer management system for veterinarian offices. The company signed an exclusive contract with a pharmaceutical manufacturer to distribute generic drugs to veterinarians. The partners designed a hypodermic syringe more suitable for animals than the human models veterinarians were then using and found a manufacturer to produce it. A chemical manufacturer contracted with them to do research and development on new products in exchange for cash and exclusive distribution rights. They learned how to get Food and Drug Administration approval of products. They purchased a testing laboratory in Chicago.

A move last December to Roslyn, Long Island, quadrupled available space. The company now has 60 employes in Long Island and Chicago.

The first outside capital infusion was

$600,000 from the Animal Medical Center in New York in exchange for company shares. Last year a public stock offering raised $3.5 million. The stock, which sold for $5 in March, was selling recently at $13—after a 2-1 split.

Revenues, $1.2 million in 1982, were $3.3 million in 1984. This year's forecast is $5 million to $6 million.

For the beginning entrepreneur, says Jacaruso, "looking for money is the hardest thing; the banks don't want to know you. A personal loan is best. If a person is truly an entrepreneur, the hours, days, weeks, nights don't mean anything. If he has a mission, he'll find a way."

And the main reward for the entrepreneur, he says, is "the creation of something, watching it happen, walking home and feeling the accomplishment of what he has achieved."

—Harry Bacas

More Beautiful The Second Time

A local newspaper calls them the "azalea 'Kings.'" And indeed they are. Joseph and Donna King have nurtured their Ruskin, Fla., azalea business as carefully as they grow the flowers, bringing it to $1.7 million in annual sales and 35 employes in six years.

In so doing, they have cornered the market on providing blooming azaleas to Florida florists and have many nurseries among their customers as well. In all, their clients number 1,600.

"Growing azaleas—that's all I've ever done except for the Army," says Joe King, 56. He got his start when he was 12, weeding azaleas in Oregon, the state where he and Donna grew up together and got married when she was just 17. Donna, too, has spent most of her adult life in the azalea business.

Nevertheless, launching their own firm, Florida Azalea Specialists, was like starting over in midlife.

After the Army, Joe worked with an Oregon azalea grower, who also grew azaleas in California. But the availability of water, reasonably priced land and closer markets drew the nursery owner and the Kings to Ruskin, near Tampa, to start a new enterprise there.

The arrangement worked well for 20 years. Donna joined the firm to sell and deliver plants. Joe became president and partner. David, the middle of their three sons, went to work in the company. But in December, 1978, Joe and his partner had a falling out. Donna and Dave were fired, and Joe quit.

Joe had never been unemployed, and he did not know what he was going to do. "But Donna and the boys said, 'Why don't you just do what you've been doing?' "

Two months later, the Kings were back in business—on their own.

Over the years, Joe and Donna had gradually acquired 31 apartments that they expected would provide the nest egg for their retirement. Now Joe and Dave built a greenhouse on an 8½-acre site also occupied by some of the Kings' apartments. Two apartments became offices.

Because they could not wait the 12 to 18 months it takes to grow plants from scratch, they bought their initial supply from an Alabama grower. To keep borrowing to a minimum, they began selling apartments one by one and putting the money, as needed, into the business.

The Kings' sons—Michael, 34, who is in charge of sales, and Dave, 31, and Jeffery, 28, who grow the plants—are now partners with their parents. Employes also include their daughter, Kathryn Dell, 32, who sells during the busy season from September to Mother's Day, and daughter-in-law Debra, Jeff's wife, a supervisor.

Joe and Donna, who have seven grandchildren, say they would not have started the firm without the help of their sons.

"The nursery business is too tough—24 hours a day, seven days a week," says Joe. "Somebody has to watch the plants. You just can't leave them." During a recent cold spell, he was at the nursery several nights, making sure the plants were protected and keeping an eye on the heaters that warm the greenhouses.

The Kings produce more than 30 varieties of azaleas in shades of red, pink, white and salmon. They still have to buy plants from other growers to keep up with the demand. Of the 340,000 plants they sold last year (from 99 cents to $23 dollars each), they grew just 160,000.

But that will change. On a 63-acre site they have bought in nearby Wimauma, they have built 75,000 square feet of greenhouse space and plan a total of 563,000 square feet. Still, says Joe, "we're not really interested in big numbers. We just want to grow plants and sell them."

The Kings frequently finish each other's thoughts. Asked how they share titles and responsibilities, Joe says, "We don't have titles because . . ." and Donna finishes, "we're not much on titles." Then Joe comes back in: "We don't like them, so we never use them. She takes care of the office, and I take care of the plants."

They feel many businesses fail because the owners spend too much on themselves instead of putting the money back into the business. Even now,

PHOTO: ERIC MENCHER

Donna and Joseph King, of Ruskin, Fla., had been in the azalea business with someone else most of their adult life. Then they had to start over, with their own business.

Donna and Joe each take out only $100 a week for themselves.

Loyal employes have also contributed to their success, they say. And how does one get that loyalty? "You treat people *nice*," says Donna.

—Sharon Nelton

Targeting High Tech Firms

Karen S. Kennedy's art gallery and boutique in the U.S. Virgin Islands was, she says, "an artistic success and a financial disaster." After three years in St. Croix, she returned in 1980 to Washington—where she had worked as an advertising agency executive—"to an environment that I understand and that I know how to make money in."

Call that an understatement. She worked briefly for two other companies and then began some free-lance consulting that quickly outgrew her home. In April, 1983, in the Washington suburb of McLean, Va., she opened KSK Communications, Ltd., which specializes in business-to-business marketing communications for high technology firms. Last year, KSK did $5.5 million in billings; this year, Kennedy expects $8.5 million.

Specializing in high tech marketing communications, Carole Bowns (left) and Karen Kennedy have created an agency that should realize $8.5 million in billings this year.

Four months after Kennedy launched KSK, she took on a partner, Carole Bowns.

"It was getting bigger than I thought faster than I thought," says Kennedy. "I knew I couldn't be a single pilot. I needed a copilot."

Bowns and Kennedy met 18 years ago when Bowns, who says she was "raising children and dogs" (25 of her dogs were champions), advertised some basset hound pups for sale. Kennedy came to see the dogs. She did not buy any, but she did make a friend.

After the end of her marriage in the mid-1970s, Bowns went to work outside the home. Her first job, in a hospital medical records department, paid $2.65 an hour. Two jobs later, she started in sales for a graphic design firm, generating $120,000 worth of business compared with the $60,000 her employer set as her goal. In six years, just before she joined KSK, she had risen to senior vice president.

KSK now has 20 employes. Kennedy, who is president, concentrates on "getting the creative work out the door," while Bowns, executive vice president, sees to administrative matters. They split sales duties.

KSK can serve as a full-service advertising agency, produce brochures and other print pieces, conduct public relations programs, create audiovisual shows and sales motivation programs, and develop corporate identity programs.

"We work on a marketing strategy with the client and come out with a comprehensive written marketing communications plan that shows where they are now, where they're trying to go, how we suggest they get there step by step, and how they can evaluate their progress," says Kennedy.

Clients include GTE Spacenet, Bell Atlantic, MCI, COM-MAIL (a division of Computer Network Corporation) and Printer Systems Corporation, a supplier of IBM-compatible peripherals.

Kennedy says she chose high tech clients as her target because "I know high tech marketing and advertising very, very well." Her field offers a growing market and, she says, there are not yet many really good agencies doing high tech work.

Occasionally, she and Bowns will turn down a potential client. "We don't represent anyone whose product or service we would not be proud of," says Kennedy.

Long range, they would like to be in a position to choose only clients that "we would love to work with," says Kennedy, explaining that clients are hard to work with when they have no comprehensive marketing plan with specific goals.

"Those are clients who will call and say, 'I need an ad,' 'I need a brochure.' Everything for them is rush, everything is an emergency, nothing is planned, and they have no way to measure what you have done for them."

Direct mail pieces created for a campaign that KSK recently conducted for Peripheral Distribution Corporation brought in responses of 22 to 24 percent (against a usual direct mail response of 1 to 2 percent). The program was designed to provide leads that could be converted into sales on equipment in the $10,000-$15,000 range. "We are told that for every $20,000 to $30,000 PDC spends with us, they get about $1.2 million in sales," Kennedy says. "We very, very carefully picked the mailing lists, and the pieces we sent were designed to elicit the kind of information the client needed. They did it much better than the client had expected and within the budget that had been set up."

Kennedy and Bowns don't much care if KSK wins any art directors' awards. Their operating philosophy: What is good is what works for a client.

—Sharon Nelton

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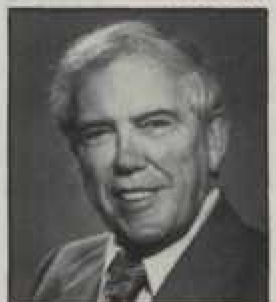
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Where I Stand

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1 Repeal Service Contract Law?

The federal government spends about $7 billion a year for service contracts. The Service Contract Act calls for contractors to pay wages set by the Labor Department using a formula that critics say inflates costs by $500 million a year and gives a competitive edge to unionized companies. The Grace Commission has recommended the act be repealed, and Rep. Arlan Stangeland (R-Minn.) has introduced a bill to do that. Should the Service Contract Act be repealed?

2 High Tech Lead In Danger?

High technology has been a bright spot in the U.S. economy, leading to impressive products. Some critics, though, say that U.S. companies have become increasingly dependent on offshore components, and that might lead to overseas manufacture of complete products and then to foreign competitors taking over the U.S. market. Others say speedy U.S. innovation will keep domestic companies successful. Is the United States in danger of losing its lead in high technology?

3 Does TV Cover Business Fairly?

In recent years the news media have put increased emphasis on business coverage. And the unblinking eye of television has presented a picture of American business seen by nearly everyone in the country. Business people, like most people, are sometimes uncomfortable with their image, and some corporate executives believe television news does them wrong. TV news executives defend their journalism. Does television news cover business fairly?

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Verdicts On Guns, Hiring, Rights Rules

Here is how readers responded to the questions in the February issue's Where I Stand poll. Results of each monthly poll go to appropriate decision makers in the White House, Congress and the regulatory agencies.

	Yes	No	Undecided
1 Should there be federal registration of handguns?	20.7%	78.3%	1.0%
2 Will your company reduce its hiring because of automation?	16.5	74.1	9.4
3 Should special civil rights rules be extended to more businesses?	7.6	86.1	6.3

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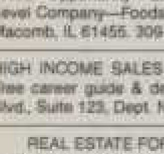

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More Than Just Numbers

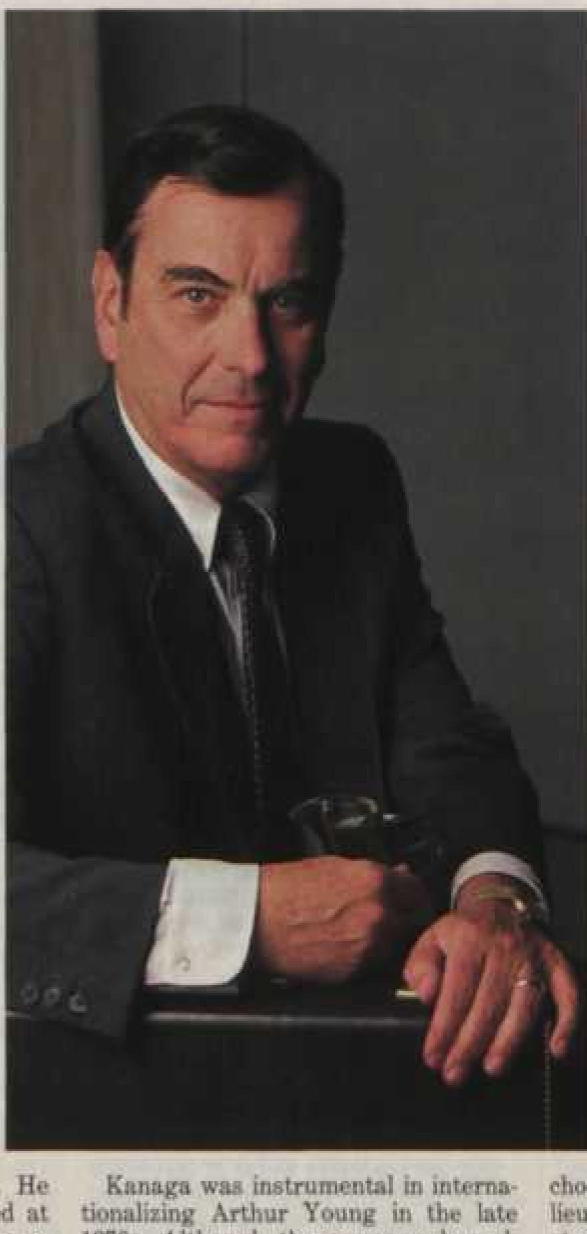
For William Kanaga, accounting is high adventure.

WILLIAM S. KANAGA thrives under stress. If a client is in trouble, Kanaga, chairman of the accounting firm of Arthur Young International, thinks nothing of flying off immediately—at times, halfway around the world—to remove a snag holding up a merger or acquisition or to help a company out of a tax quandary.

"I feel comfortable in pressure-cooker situations," he says.

Observes Arthur Young's managing partner, Bill Gladstone: "He can really maintain his cool; he's the total professional. When you couple this with his ability to really understand a client's problems and see what opportunities are available from the client's perspective, it's a dynamite combination." Some of the clients Kanaga has served rank among the biggest corporations—Mobil, PepsiCo, American Airlines, American Express and Sperry.

Friends and associates call Kanaga a very positive, can-do person. He radiates energy, and that is an important asset for a job that involves overseeing 23,000 persons—including almost 18,000 accounting professionals—in 351 cities in 66 countries. Arthur Young is the fifth largest accounting firm.



Kanaga turns 60 this August, and company policy dictates that he retire, even though he has the vitality, not to mention the looks (his hair is still glossy black), of a much younger man. He talks of what he has accomplished at Arthur Young during his five years as managing partner and eight as chairman: "If there's anything that the partners will remember me by, it's being available in a crisis." His achievements extend beyond that, Gladstone counters. "He has led the firm through industry changes from a professional environment to a competitive business environment, making us more responsive to market demands. He has been a very effective leader."

Kanaga was instrumental in internationalizing Arthur Young in the late 1970s. Although the company has always had offices overseas, the emphasis was on installing American partners abroad to handle the overseas investments and businesses of mainly U.S. corporations. Kanaga felt that Arthur Young should not run "Anglo-Saxon outposts" in other countries but should instead put citizens of those countries in charge. The strategy has been successful. "We are now looked upon as a national firm in each country," Kanaga says.

He has also led Arthur Young into an era of specialization. He believes strongly that accounting is following the path trod by the medical profession: more specialists, fewer generalists. The firm has not only its traditional functional specialists—accounting, auditing and tax professionals, management consultants and bankruptcy and litigation support pros—but also more specialized specialists. These are industry specialists, who combine an interest in a particular industry with a love for accounting. They become proficient in speaking that industry's language, able to answer any technical questions that crop up and ready to tackle whatever business or regulatory issues the industry may face. Arthur Young has specialists covering more than two dozen industries.

Kanaga says the growing complexity of industries like high technology, financial services and health care requires that Arthur Young have experts in the field who can tackle a problem at a moment's notice, grasp quickly what is going on and expedite a solution.

Unfortunately for Arthur Young, industry specialization has its costs. "Our clients are apt to steal Arthur Young employes," Kanaga notes wryly. "Clients see them in action and know just what they can do, so they're much more confident choosing one of our professionals in lieu of someone walking in off the street."

The blending of specialization and internationalization can be seen readily in Arthur Young's work on foreign taxes incurred by Americans living abroad—a specialty in which it has emerged the leader.

"The large multinational corporations are sending expatriate personnel into many different parts of the world," Kanaga explains. "When American executives, for example, go into a foreign

country, they have to contend not only with that nation's taxes but with their own country's as well. Then you have cases where an American employe is transferred from Hong Kong, where taxes may be 10 percent of income, to Japan, where they're 60 percent. It's our job to ensure that Americans overseas are not affected by location."

The entrepreneurial services division, which caters to the concerns of smaller businesses, has also blossomed under Kanaga. It is Arthur Young's role, he says, to guide such businesses through economic changes—helping entrepreneurs build for financial health and assisting them in determining the value of their enterprises; showing them how to keep pace with growth; and giving them whatever advice and assistance is necessary when they go public or merge.

Arthur Young has mounted a marketing campaign to increase public awareness of its services. "We sponsored a marketing survey of how people perceive us, and the findings were a little dismaying," Kanaga says. "We found that, generally, the public sees accounting firms as coming from the same mold and having no distinguishing features."

Print ads are appearing in major consumer and business publications, each carrying this tag line: "We take business personally."

Another ploy to give Arthur Young a stronger identity has been publication of a consumer tax manual, written in simple, understandable language and sold in bookstores. Kanaga touts it as "the most comprehensive and finest book available for individuals."

It has been a rewarding 31 years at Arthur Young for Kanaga—especially considering that accounting was only a career afterthought.

He always had a good head for figures, and at the University of Kansas his fancy was caught by metallurgical engineering. Although his education was interrupted by active service as a Navy ensign in 1945 and 1946, he graduated with an engineering degree in 1947. But the job possibilities in metallurgical engineering seemed limited and rather dull.

His career choice up in the air, he took a bachelor's degree in business administration at Babson College, a small school in Massachusetts. Then, jobless, he went back to Kansas—and was turned on to public accounting by family friends, one of whom was a partner in Arthur Young's Kansas City office.

"Public accounting sounded intriguing," Kanaga recalls. "I was told that as long as I didn't know what I wanted to do, this would expose me to a lot of different industries, so I could pick one I liked. But I never thought it would end up being my career."

Kanaga went to work for Arthur Young in 1949. His first assignment was a three-year training stint in New York City, to be followed by a return to Kansas City. He has yet to make that return trip.

An international traveler who has logged millions of miles, William Kanaga is a familiar figure at airline counters.

Other work in New York for Arthur Young followed. Then Kanaga took a job with an insurance brokerage, spending four years in its New York office.

HE CREDITS his years in insurance with tempering his youthful brashness and cockiness. "Public accounting in those days consisted of going in and telling clients what they had done wrong—period," he says. Insurance, Kanaga says, trained him to be "sensitive to people," to see the pressures that companies are under and how they can make honest mistakes. He learned how to deal with such mistakes tactfully, he says. "It's training that I've used ever since."

But the narrower world of insurance did not have the spice, the excitement, the challenges of public accounting, with its broad spectrum of financial problems. So, Kanaga returned to Arthur Young in 1958 and in rapid succession became a manager, a principal and in 1960, at the age of 35, a partner.

For 11 years, from the time he rejoined the firm until he became the managing partner in the New York headquarters in 1969, Kanaga traveled between 125,000 and 150,000 miles a year, because many of his clients had a major part of their operations outside the United States. Once he became the firm's managing partner in 1972, he cut down on his travel. But as chairman, he travels frequently and tirelessly, visiting the firm's many offices and keeping up to date on the international scene. And there are the inevitable crises.

The time he has had to devote to travel has been, Kanaga admits, tough on him, his wife, Sally, and their three children. "When you love what you're doing," he says, "it takes a lot to keep it in hand and prevent it from overwhelming the rest of your life."

Kanaga is, however, close to his children—son Christopher, a lawyer on Cape Cod, son Clinton, a graduate student in landscape architecture at the University of Massachusetts, and daughter Ann, who lives on Cape Cod a block from a house her parents built in 1981.

He is also a devoted Christian. These days, when time permits, Kanaga gathers with Donald Siebert, retired chairman of J.C. Penney, and Howard Kauffmann, president of Exxon, for morning Bible study.

Despite time pressures, Kanaga manages in addition to serve on the board of directors of the U.S. Chamber of Commerce.

With retirement only a few months away, does he have any regrets? "I think that after 13 years in the two top positions, it will be a good idea for me to pull out and retire," he says. "But I still want to keep close ties with the firm in some advisory capacity."

There is no question that he will be active.

There will be the centennial celebration of the accounting profession in 1987, for which he is chairman. There are boards of directors to serve on, from hospitals and clubs to educational institutions. He will be able to channel more energy into his church work.

But life will still be very different. After 35 years, Kanaga will be leaving New York for the Cape, to play tennis and stroll the beaches. "No other activity clears the cobwebs from your head like walking the shore," he says. "It'll be kind of strange, having grown up on my mother's farm [she is 92 and still lives alone], and retiring on the Cape.

"Imagine me, a Kansas farm boy, sitting on First Encounter Beach where the Pilgrims tried to land before attempting Plymouth Rock instead. It's certainly a far cry from the Kansas plains and midtown Manhattan."

—Mary-Margaret Wantuck

What You Can Do About Washington Issues That Affect Your Business

This NATION'S BUSINESS feature advises readers how they can make their views known on important pending legislation. Correspondence to members and committees of Congress can be sent either c/o U.S. Senate, Washington, D.C. 20510 or U.S. House of Representatives, Washington, D.C. 20515.

Issue	Potential Impact On Business	Contact And Business Message
FISCAL '86 BUDGET	The administration has identified several programs for reduction or elimination to produce a $50 billion spending cut. Deficit spending debate will center on spending restraint, tax increases and pro-growth economic policies.	Members of the House and Senate: To control the runaway federal deficit, Congress must reduce federal spending and promote pro-growth economic policies.
TAX REFORM/SIMPLIFICATION	The administration and Congress are presenting plans to simplify the tax code. Treasury calls for eliminating most special credits and deductions and for lowering rates across the board. Business tax rates are subject to change.	Members of the House and Senate: Carefully study all the various tax simplification proposals. Do not pass a tax increase package under the guise of tax reform or simplification.
TAXATION OF EMPLOYE BENEFITS	In the search for ways to reduce the federal budget deficit, taxation of employe benefits could be targeted as one way to increase revenue. Treasury plans to change or terminate tax-favored treatment of employe benefits.	Members of the House and Senate: Oppose broadening taxation of employe benefits, support use of tax incentives to encourage the private benefits system.
SUPERFUND	The current five-year, $1.6 billion toxic waste cleanup program expires September 30. The EPA will seek about $1 billion annually for cleanup of hazardous waste dumps. Business will be required to pay a share of the cleanup cost.	Members of the House and Senate: Reauthorize the Superfund at reasonable funding levels. Money that cannot be used efffectively will not solve the toxic waste problem.
COMPARABLE WORTH	Advocates of comparable worth will push this year for passage of legislation that would set a value for each job based on a subjective point system. Implementation would cost employers hundreds of billions of dollars.	Members of the House and Senate: Oppose government-mandated comparable worth legislation that would interfere with free market systems and be extraordinarily costly to implement nationwide.
IMMIGRATION	The most controversial issues of immigration reform will be sanctions against employers who hire illegal aliens, complex verification and recordkeeping requirements and the creation of new protections against discrimination based on alien status and national origin.	Members of the House and Senate: The government should enforce current laws more effectively rather than require the business community to handle government's responsibilities. Oppose legislation making the employer an enforcer.
EXPORT ADMINISTRATION ACT	Congress must renew the Export Administration Act, which authorizes government control on exports to protect national security and promote foreign trade. The President is currently monitoring exports under emergency powers. Quick action on a new bill is vital.	Members of the House and Senate: Early congressional passage is needed of a bill streamlining our foreign trade licensing regulations. Reauthorization should preserve contract sanctity.

Free Trade Cannot Be One-Sided

President Reagan's decision to permit the scheduled expiration of import quotas on Japanese automobiles is particularly significant because it comes at a time of unusually intense acrimony in U.S.-Japanese trade relations (see article on page 42).

American negotiators have been having great difficulty in talks intended to implement the more open trade policies agreed to by President Reagan and Prime Minister Nakasone at their summit meeting early this year.

U.S. officials charge that Japan remains adamantly against opening its markets to U.S. goods that include telecommunications, electronic and medical equipment; wood and paper products; and pharmaceuticals.

Given what American trade negotiators have described as Japanese intransigence in the talks, President Reagan could well have demanded a quid pro quo for the elimination of the auto quotas. He did not do so. He did, however, express hope that "we can look forward to reciprocal treatment" in the talks.

Strong protectionist sentiments are building in this country. Our trading partners in Japan could help themselves through prompt action on Reagan's suggestion for reciprocity.

Congress Ploughs A Crooked Furrow

Several disturbing aspects surround the rush by Congress to provide sharply increased federal aid to debt-ridden farmers—a rush stemmed by presidential veto.

One is the precedent the legislators set in the first key test of their willingness to make difficult decisions on containing the federal deficit, regardless of what special-interest ox might be gored.

The fact that Congress yielded on this initial test of spending restraint is not encouraging. There is a long line of other special-interest groups ready to plead against proposals to reduce federal spending in their areas.

Also worrisome is the extent to which many in Congress, who might normally support budget restraint, leaped on the farm relief bandwagon out of fear of political reprisals.

California's Tony Coelho, chairman of the Democratic Congressional Campaign Committee, said of President Reagan's opposition to the costly relief bill: "He is creating an [election] opportunity for Democrats."

It remains to be seen, however, whether the maximum political advantage lies in short-term financial relief for one sector of the economy or in fiscal policies that benefit all voters.

Finally, Congress' farm bill action reflects the idea that solving rural America's problems requires ever-increasing amounts of federal spending. Advocates of the vetoed legislation must realize that excessive federal involvement has been the cause of, not the answer to, the plight of many farmers.

No Silver Lining For Organized Labor

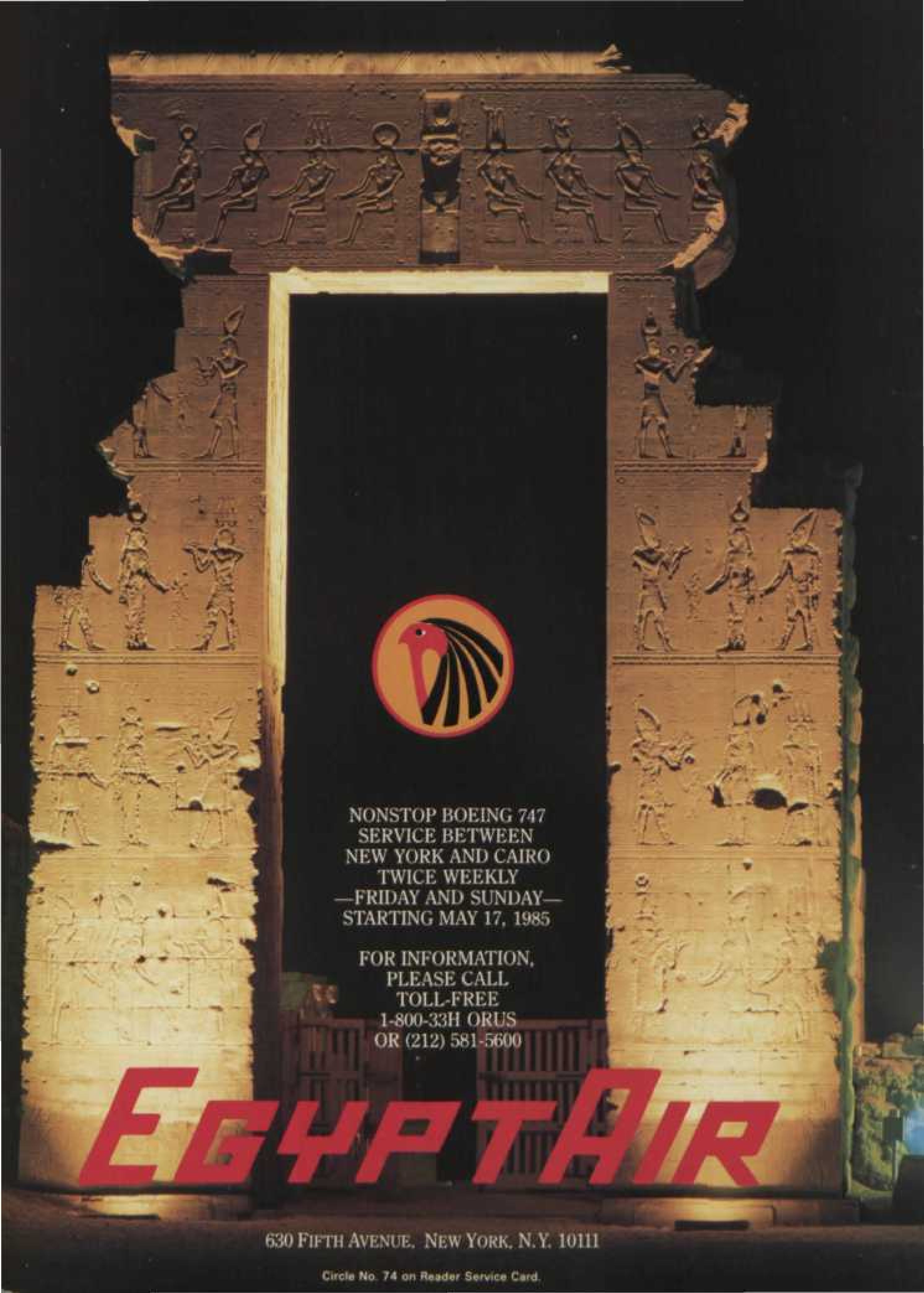
Recent events in Idaho demonstrate that organized labor itself is responsible for many of the serious problems it now faces (see article on page 29).

Workers and owners of the Bunker Hill silver mine agreed on a package designed to keep open. But United Steelworkers Union leaders vetoed the settlement, the mine was closed and 2,000 jobs were lost.

Early this year, Idaho became the 21st state to pass a right-to-work law. Events at the Bunker Hill mine were considered a major factor in the state legislature's willingness to enact the law and then override the veto of a governor who had big labor's support in his election campaign.

The new law, adopted under provisions of the federal Taft-Hartley Act, bans labor-management agreements that make union membership a requirement for employment.

Idaho's approval of a right-to-work law has put new momentum behind efforts in other states on behalf of such laws. And "Bunker Hill" takes on added significance in terms of individual rights vs. coercion.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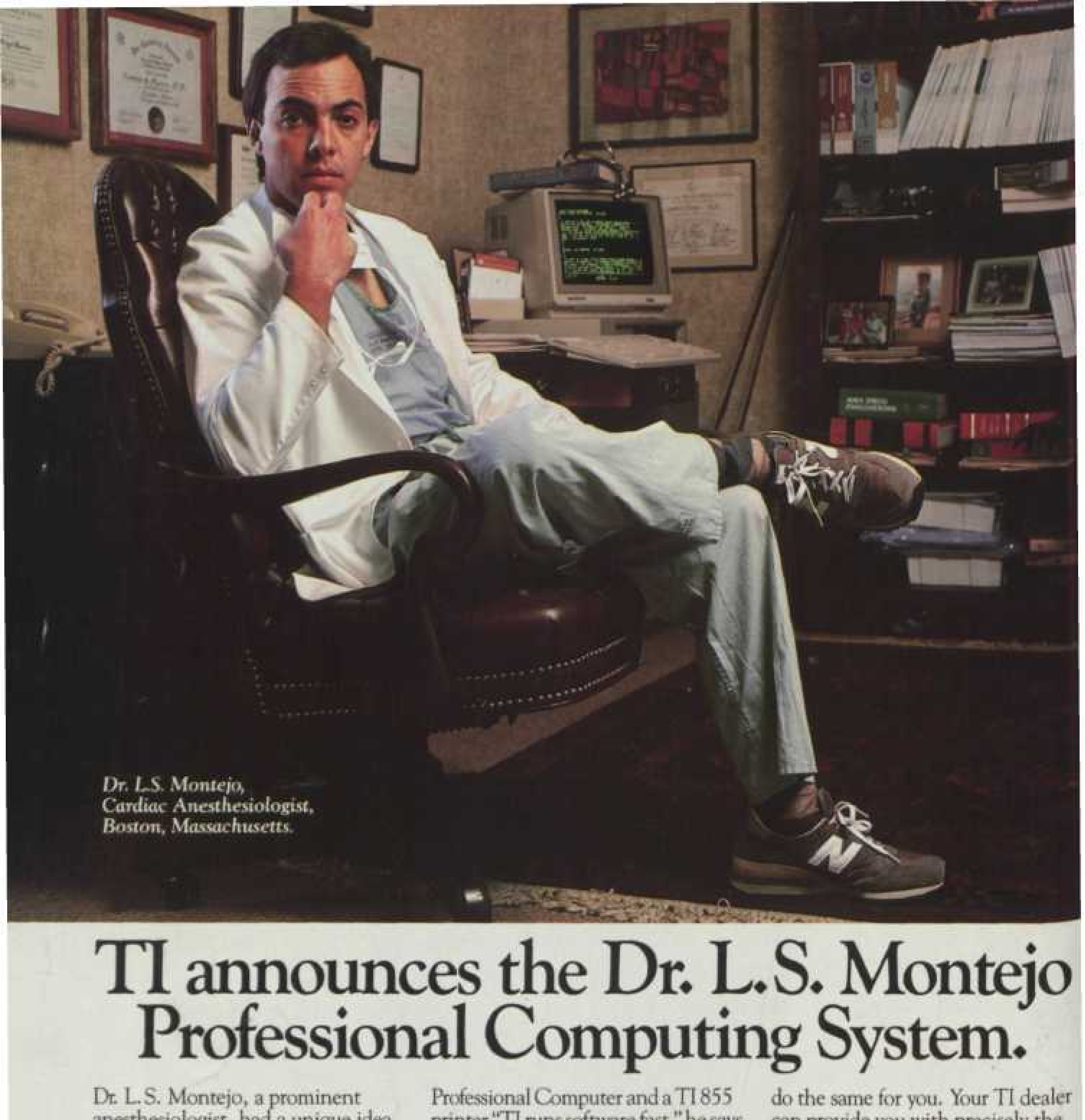

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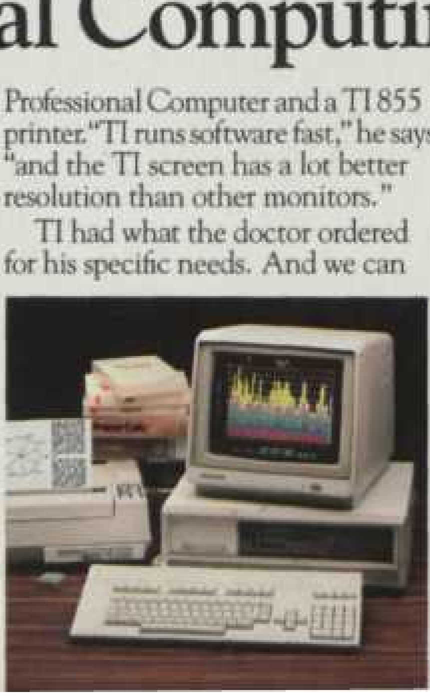

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